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Financial management in department
and agencies of the government
of Canada



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IN DEPARTMENTS AND AGENCIES
OF THE GOVERNMENT OF CANADA



FINANCIAL MANAGEMENT

IN DEPARTMENTS AND AGENCIES OF THE GOVERNMENT OF CANADA

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Preface

The Report of the Royal Commission on Government Organization correctly observed that good management like good coffee depends on the quality of the raw material and the care devoted to its preparation, but added sadly it was unable to recommend any recipe for instant management. Neither can Treasury Board. The appearance of this guide should not therefore be heralded as announcing to an expectant public service the discovery of the miraculous recipe.

However, it does mark an important stage in the acceptance and application by the federal government of modern and proven methods of financial management to meet its special requirements. In substance the guide is the distillation of findings and recommendations from several inquiries. Earliest in time were the Glassco Commission recommendations chosen by the government to test for applicability and value in four large operating departments: Agriculture, Northern Affairs, Transport, and Veterans Affairs. Four teams of management consultants and civil servants were recruited for this purpose, operating with the guidance of a co-ordinating committee. This committee in turn reviewed and analyzed team reports, giving its views on applicability and value. On all major points there was impressive unanimity about what constituted good financial management in government and how it could be attained.

For this reason Treasury Board directed that a guide on this subject should be distributed to all departments and agencies. However, pending its preparation, the board approved distribution of a summary of approved principles for good financial management to accelerate action by all concerned to put them into effect. This was done by Management Improvement Policy No. MI-3-66, included in this guide as Appendix 1.

What then is the relation between the policy statement and the guide? The policy statement is both the official declaration and, it is hoped, a convenient summary for reference purposes; whereas the guide, prepared by the management improvement branch of Treasury Board, is an elaboration of the policy statement.

All major ingredients for a sound system are described but their mix for a given organization is obviously not prescribable in the fineness of detail needed for the creation and operation of a satisfactory system. For example, the advantages of accrual accounting are set forth; yet there are operations to which it cannot be usefully applied. Each department and agency must make its own application of the general doctrine, but be prepared to defend its deviation from any of its major principles.

The government approved two major recommendations of the Glassco Commission that made improvement in financial management the joint task of the board and the departments. The first recommendation would give to departments the necessary financial authority to hold them accountable for the effective management of financial resources placed at their disposal, while

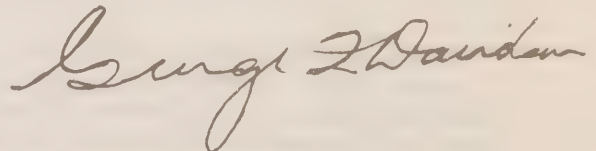
the second provided for Treasury Board to continue to lay down policies on financial and administrative matters, but in a less restrictive manner. Only an active partnership can do the job. In particular, the drive for improvement must come from all deputy heads and other senior officers.

The essential purpose of any guide is to convey meanings precisely, not to entertain or edify. The subject matter of this one, drawing as it does upon several arts and sciences, inevitably uses some of their technical vocabularies. Faced with the dilemma of choosing between conveying some meaning clearly and simply, or conveying the meaning precisely but with unavoidable elaboration, we have necessarily followed the latter course but with some compromise. The guide, while not sacrificing precision to a specious simplicity, is written for the generalist, the official who needs to know what modern financial management is about, what it can do for him in the performance of his duties, and what might be expected of him.

Distribution is being made before policy has been decided about pre-audit and certain other accounting responsibilities of the Comptroller of the Treasury because of the overriding need to get on with the job.

A British author dedicated one of his novels to "My dear wife, without whose help this novel would have been finished in half the time". The guide could have been finished in less time but only at the expense of foregoing valuable contributions from many sources. To all those who have had a hand in its preparation sincere thanks are extended, and particular appreciation is expressed to those who took time from their heavy responsibilities to comment on earlier drafts.

This guide is not the last word on this subject because financial management techniques are far from static. On the assumption that other techniques will emerge and from the experience of the users of this guide, it may be necessary to issue later editions. But as an introduction, it deserves and will repay close study.

A handwritten signature in dark ink, reading "George F. Davidson". The signature is fluid and cursive, with the first name "George" and last name "Davidson" clearly legible.

George F. Davidson,
Secretary.

Introduction

The financial management system set out in this guide emphasizes the use of two key tools, program budgeting and responsibility accounting. But tools have to be made before they can be used, and designed before they can be made, if they are to be nicely suited to their many purposes. What are these purposes? In the most general terms, they are the department's mission in life as defined by statute and other authorities, such as ministerial direction, and its plan or, more likely, set of plans for the best ways and means to accomplish that mission. Therefore, the logic of the subject requires the guide to start at the beginning of managerial functions generally, if the special nature and value of financial management are to be seen in proper perspective.

For convenience of presentation, these managerial functions are divided into:

1. forecasting and planning operations by programs, activities and responsibility centres;
2. preparing the budget by areas of activity and responsibility, and reporting results at such intervals that corrective action, if necessary, can be taken in time; and
3. accounting for or recording expenditures and revenues under the budget.

Separate chapters (IV, V and VI) are devoted to each of these major subjects. Financial management as a function cannot be isolated from other managerial functions and is a responsibility of each unit of management. To discharge their responsibilities adequately, managers at various levels will be assisted by specialists in the field of financial management. This is the subject of the next chapter. Specific direction on how to introduce financial management is given in Chapter VIII.

All managers have duties peculiar to their respective tasks, but all alike share a uniting purpose: they have to control the operations for which they are responsible. Control problems at each stage will be described in context. But there is also a change of attitude to control that must be understood at the outset.

Managers are concerned not with doing things themselves but with seeing that certain things are done and done by approved means. Since managers in large-scale organizations cannot directly oversee or supervise all the operations for which they are accountable, they must have instruments of control adequate for their purposes, in effect, extensions of eyes, ears and voice. The Glassco Commission's main criticism of the government's control system was in substance that the eyes read mainly the letter of the law, the ears were too often deaf to well-grounded complaints by line operators about inflexibility, while the voice usually sounded warnings rather than giving leadership and encouragement. This is negative control, admittedly necessary in any system that is to be lawful and held to account before Parliament, but not sufficient in itself to produce a system oriented to reaching approved goals.

This guide describes new departures already made or contemplated to rid control of its frustrating associations and to express its positive modern meaning. Control is the intelligent use of all means to cause and guide events favourable to the fulfilment of an approved plan, or to prevent the occurrence of or to deflect events that hinder fulfilment. Greater freedom to manage forms part of the greater authority being given and to be given to departments.

The speed and direction of this delegation obviously have to conform to accepted constitutional principles and practices set forth in the Financial Administration Act and other relevant legislation. But in planning its financial management system, the department should assume it will be given the authority needed to match the responsibility allotted to every level of management, provided the right officials are in the right places.

There is a danger inherent in encouraging departments and agencies to build accounting and reporting systems tailor-made according to their own designs. Carried to extremes the result could be a multiplicity of systems, not only inconsistent as between departments, but unable to provide readily the data required by various statutory authorities for their reports to Parliament. Moreover such diversity would undoubtedly add greatly to administrative costs. To reduce these possibilities, the guidance of the Comptroller of the Treasury should be sought.

A recurring theme in the guide is the accountability of managers for performance. This prompts the question what sanctions will be used if performance is unsatisfactory. Although the guide proposes no answer to this question, nevertheless, the new system does require the application of sanctions. The opportunities for skilful and effective management provided by the new system should, therefore, be regarded as a continuing challenge to make performance match required standards.

For progress in the immediate future many opportunities now exist, without statutory amendment, to initiate or accelerate suitable financial management studies and put approved proposals into effect. This is the subject of the last chapter. The present authority of deputy heads is sufficient to permit not only short steps to be taken but for long strides to be made towards the common objective: the best financial management system our collective wisdom can devise.

Organization for Financial Management

Heavier demands will be made on the use of financial management techniques as a result of the greater delegation of authority to department and agency heads and from them to departmental officers. One of the essential steps to introduce them is to establish an appropriate financial management advisory unit in each department. Accordingly this chapter describes (1) organization of the unit, (2) the duties of the Departmental Financial Management Adviser (DFMA) and others, (3) their qualifications, and (4) staff recruitment.

ORGANIZATION

Under each deputy head, this unit performs primarily a staff function of service and advice to line management at all levels.

To ensure the consistency and quality of financial service and advice, it is essential that the members of this unit are located at various levels of management in the department under the functional direction of a senior officer responsible to the deputy head. After assisting his department to select and put into effect the most suitable financial management system (See Chapter VIII.), his continuing duties would be to provide service, advice and direction on financial management matters within the department. Therefore, a suitable title for his position might be DFMA, and other officers with similar functions, depending on their location, Branch Financial Management Advisers (BFMA) or Regional Financial Management Advisers (RFMA) and so on. Alternatively, Departmental Controller might be used as a title more in keeping with industrial usage.

DUTIES OF FINANCIAL MANAGEMENT STAFF

The duties of DFMA's cover most but not necessarily all of the following subjects, explained in detail in subsequent chapters.

1. Financial Planning

- (a) Participating in short-range and long-range planning by providing a financial evaluation of various courses of action.
- (b) Interpreting the financial implications of legislation and regulations to all levels of management and preparing procedural manuals and instructions for the proper observance of such regulations.

(c) Ensuring that programs and activities are adequately defined.

2. Budget Preparation and Expenditure Control

- (a) Guiding and assisting in the statement of plans, terms of budgets and estimate submissions.
- (b) Reviewing critically the line managers' draft budgets with them, and consolidating the department's budgets into an estimates submission to Treasury Board.
- (c) Establishing a suitable classification of expenditures for control, in keeping with the department's system of program budgeting and responsibility accounting and the requirements of the government generally.
- (d) Managing cash requirements.

3. Accounting Systems and Procedures

- (a) Ensuring that an effective system of accounting, incorporating budgetary and internal controls, is developed and available to meet departmental needs.
- (b) Ensuring that a suitable cost accounting system is developed and available to meet departmental needs.
- (c) Initiating special cost and work measurement studies, where applicable, including consideration of the make-or-buy alternative.
- (d) Advising the deputy minister and heads of operating services, branches and divisions, on the most effective use of the accounting system.
- (e) Ensuring that departmental accounting, budgeting, financial and statistical reporting systems and procedures are reviewed periodically and improvements made as required.

4. Reporting for Management Control

- (a) Directing and developing a departmental information system to report financial and other relevant data to various levels of management; to show the results of operations; and to point out significant variations between the budget and actual performance.
- (b) Ensuring that all financial documents required by legislation or regulations are properly prepared and submitted on time.

5. Control and Safekeeping of Assets

Establishing procedures for the control and safekeeping of inventories and for the handling and safekeeping of cash, materials, equipment and property.

6. Financial Liaison

Establishing and maintaining effective liaison with Treasury Board staff, Comptroller of the Treasury, Auditor General, and other departments and agencies, and proposing desirable changes in existing financial regulations for the control of departmental activities by external control agencies.

7. Training for the FMA Staff

Advising on and participating in a system for the development of financial management staff, including on-the-job training.

The principal duties of BFMA's and RFMA's are to:

- (a) provide an advisory service to the branch or regional managers and to assist them in the effective use of financial resources;
- (b) provide functional leadership and guidance to promote effective performance by subordinate financial staff;
- (c) assist their superiors with the preparation of their budgets; and
- (d) implement accounting and financial reporting systems for management control.

The details of the organization, including the relations between subordinate FMA's and the DFMA, must be designed to meet the particular requirements of the department. It is essential, however, for them all to realize that they are staff officers who serve in an advisory capacity to operating managers. This role does not imply that the DFMA is excluded from the management team; on the contrary, it stresses how important it is for him to be integrated with the management team.

The financial management organization may, of course, be given responsibility for duties other than those of a purely financial nature, such as administration, management advisory services, material management, and direction of a data-processing centre. In the area of operational audit, where it is important to maintain independence and objectivity, the responsible officer should report to the deputy head or an assistant deputy. In exceptional cases, however, it may be necessary to deviate from this principle in order to keep within workable limits the number of officers reporting directly to the deputy head.

QUALIFICATIONS

Such a complex and responsible role for financial managers will undoubtedly require more highly developed professional skills at all levels than are usually available at present. If financial management organizations are to be of value to line managers, they must be properly staffed. Accounting knowledge and experience are not enough; financial information must be developed and presented in such a way as to stimulate and guide management action. The DFMA must, therefore:

1. be proficient in all aspects of financial management;
2. be creative and capable of designing or modifying existing reporting and accounting systems to meet changing conditions;
3. be familiar with the operations and goals of the organization he serves, and the financial organization of the Government of Canada;
4. have above-average ability to communicate effectively;
5. be flexible and open-minded;
6. be persuasive with operating personnel in promoting the introduction of an adequate financial management system; and
7. have a general knowledge of automatic data-processing equipment.

Ideally, he should combine a knowledge of accounting and finance with that of government and the operation of his department. In some departments the procedures needed are fairly simple,

in others, more sophisticated accounting systems and procedures are required, in which case it is desirable that the DFMA be well qualified, preferably to professional standards.

Similar qualifications would be expected for his staff.

RECRUITMENT

Having established the necessary qualifications for its FMA staff, the department should next attempt to determine its requirements and assess existing staff. In view of the emphasis placed upon a knowledge of the department, consideration should be given to using present employees for the jobs to be filled. Requirements for training will exist and suitable training programs should be developed in cooperation with central agencies. After examining these sources, consideration should be given to the number and levels of new employees that must be recruited.

A career plan should be developed that provides opportunity for transfer, not only within the financial management organization (e.g. from the field to headquarters), but also within the department to line management positions.

Having outlined the basic concepts of a departmental organization for financial management and emphasized the need for well-qualified staff, the guide will next deal with the financial management system itself in the following four chapters.

Forecasting and Planning

If managers at all levels of government are to be held accountable for the results of their operations, then what they are to be accountable for must be known to them, their superiors and subordinates. A written statement is needed of the objectives to pursue and how to pursue them. In brief, operations have to be planned: that is, what is to be done; how much is to be done and by what methods and stages; what resources are required; and how the results are to be measured and evaluated – all these elements in the planning process have to be made explicit.

Accordingly, this chapter is devoted to two major subjects. Section I sets forth the objectives, the organizational levels, and nature of planning, emphasizing particularly the requirements of the new approach to long-range planning and program review. Section II describes how plans are to be expressed in terms of programs by activities and responsibility centres, so as to permit the application of the principles and requirements set forth in section I.

SECTION I

PLANNING

1. Objectives and Levels of Planning

It will assist the reader to have before him a short presentation of the five levels of government at which planning is and will be conducted, together with a brief indication of the objectives and requirements for each level. This will provide him with a picture of the new organizational framework for planning and a picture of his role in that framework.

The all-inclusive objective of the new approach to planning is to establish a system producing a set of departmental plans whose form and design are common, but broad enough to accommodate the operational needs and requests of each department, the secretariat of the Treasury Board, the board itself, the federal budgetary planners, and Parliament – in all five levels of planning.

Such a system should provide:

(a) *for a department*

– a means of formulating and evaluating alternative programs in the planning stage;

- a means for designing, planning and budgeting operations for both short and long periods of time;
- a means of monitoring the progress of operations; and
- a means of evaluating the effectiveness of implementation of a plan through analysis of performance.

(b) *for the secretariat of the Treasury Board*

- a means of analysing departmental requirements by objectives, programs, and activities;
- a method of assessing the performance of a department by reliable measures and in terms of comparisons of actual performance against departmental plans;
- a means for advising the board on the implications of alternative allocations of resources; and
- a means for recognizing the need for regrouping of activities between departments through analysis of objectives, programs and expenditures.

(c) *for the Treasury Board*

- a means for allocation of governmental resources in accordance with governmental policy based on social, political, and economic considerations.

(d) *for the federal budgetary planners*

- an aid to the process of budget design by providing suitably classified forecasts of expenditure;
- a means for monitoring the progress of such a program of expenditures in a manner required by the planners; and
- an aid to the process of budget design by providing any required classification of proposed expenditures.

(e) *for Parliament*

- a means for appraising departmental programs in terms of real objectives, and their effect on Canadian society;
- a means of verifying the departmental program of expenditures within the context of approved legislation; and
- a means of monitoring the total program of expenditures.

2. Program Planning

This sub-section first describes the nature of program planning and then emphasizes in some detail its two distinctive features, measures of effectiveness and analysis of alternatives.

(a) *The Nature of Program Planning*

Consider first the point of view of a manager. His primary responsibility is to allocate and use scarce resources in such a way as to achieve maximum effectiveness in meeting the objectives of his organization in the most economical way. He is constantly faced with deciding the priority of the various tasks to be done and their relative importance in meeting the total objectives. He has to decide which task should receive what part of his resources. He has to decide what mix of jobs he will do next month or next year if he is given fewer resources than he thinks necessary. He must find methods to assess the effectiveness of each task in meeting objectives in order to evaluate results.

To do all these things he and his department must have a long-range plan including the following elements:

- (i) precise description of the objective, or a set of them, for his area of authority and responsibility;

- (ii) one or more plans of action to meet his objectives fully and a statement of what will be accomplished, that is, the goals for each unit of time used in the plan, in as precise terms as possible;
- (iii) alternative plans of action in case his resources are reduced;
- (iv) measures to judge effectiveness in meeting his objectives; and
- (v) measures to judge efficiency.

This is program planning.

Some of the techniques of the financial management system contribute to program planning by assisting managers to cost alternative plans and to prepare their budgets. This subject is dealt with in more detail in Chapter V.

Program plans include the five elements listed above, whereas the financial budget is the set of all such plans expressed in monetary terms.

(b) *Measures of Effectiveness*

A measure of effectiveness is the essential tool required to evaluate the benefits of an activity. It is the principal tool of a planner designing an activity; it is the principal tool of the decision-maker assigning the resources to carry out the activity; and it is the principal tool of the evaluator in judging the significance of the real benefits of an activity. An activity in this sense is always a set of actions chosen for their expected contribution to the realization of an accepted objective.

To illustrate, if a department is concerned with building highways, it might use as measures of effectiveness the number of people or the ton/miles of freight transported over a highway in a year. But to decide on such measures, the department must first state its objectives with precision. In long-range planning these are usually expressed in terms of the economic or social development of the country. In this example, the objective is not merely to build highways, but to build them for specific purposes such as:

- to decrease the travel time between urban centres, or
- to provide easy access to a tourist area, or
- to open up a mining area in a remote location.

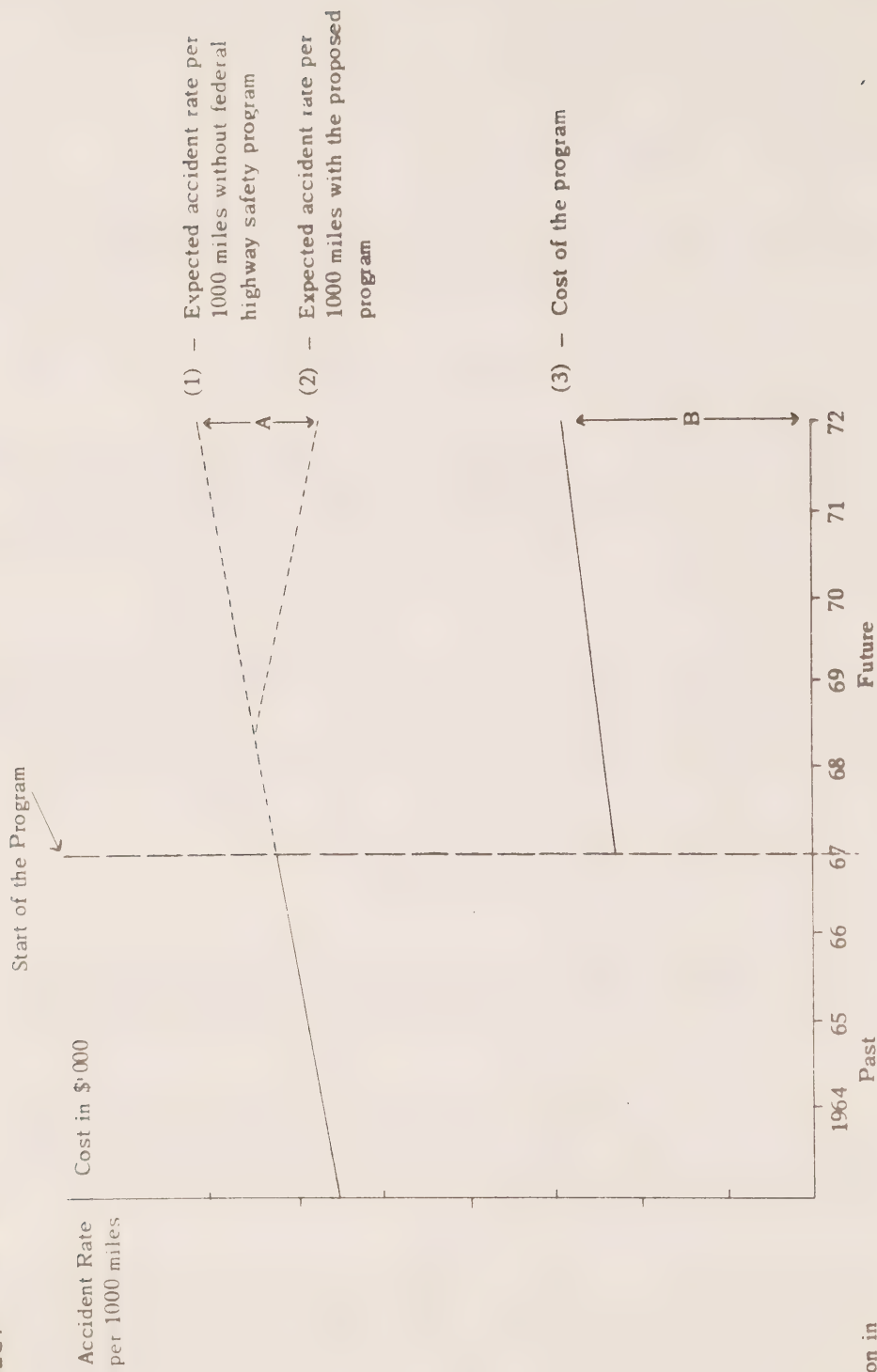
Each measure of effectiveness, and there may be a number of them, relates to how effective the highway will be in fulfilling the stated objective. In describing these objectives, and in determining measures of effectiveness, the emphasis is on the purpose of the program; the financial costing of plans is subsidiary to the planning approach.

A measure of effectiveness is not a measure of performance. The former gauges the achievement of an objective, and not the number of units of output. Thus, in the highways example, one measure of effectiveness might be the use of a highway in terms of the number of people it will carry between localities but the measure of performance might be the number of miles of highway built.

If the department is concerned with traffic safety, the measure of performance is the number of miles of highway patrolled, the number of people on school patrols, the number of pamphlets and advertisements relating to safety distributed to the public, and the cost of the safety devices introduced into cars over a period of time. However, there is only one measure of effectiveness, that is, the rate of accidents, expressed in terms of injuries and deaths, or in cost of damage to people and property.

Thus, a measure of effectiveness is a yardstick to assess the real value (or output) of an activity in terms of its quantitative benefits resulting from the related expenditure. It should not be confused with either measures of performance or measures of work

MEASURE OF EFFECTIVENESS
DIRECT



$$\frac{A}{B} = \frac{\text{Reduction in the rate of accidents per } \$1000}{\text{Cost of the program}}$$

The ratio $\frac{A}{B}$ is a direct measure of effectiveness.

FIGURE 1

(work-measurement) to be performed at standard rates. Therefore the concept of efficiency, which relates to performance, is not the same thing as the concept of effectiveness, which considers the value of output, not primarily in dollars, but in terms of its contribution to the objective. It should be obvious that activities stated in dollars of cost do not in themselves provide measures of effectiveness, for only half of the requirement of the description of a measure of effectiveness is satisfied. The real value of output has not yet been ascertained. How this can be done will now be considered.

The principal question in the issue of measures of effectiveness is whether these measures can be provided for all or most activities of the federal government.

It is believed that over a period of time most activities can be structured in such a manner that measures can be provided, but this remains to be proven in experience. It is worth noting that measures of effectiveness do not always have to be based upon the direct effects of an activity. In fact it may not always be possible to do so because the direct effects cannot be measured. Sometimes therefore it is necessary to take a more indirect approach. The following examples will clarify this distinction between direct and indirect measures of effectiveness:

(i) *A Direct Measure of Effectiveness* (See Figure 1.)

Assume that the federal government is going to promote highway safety. The objective would be the reduction of accident rates of all types resulting from automotive accidents on highways. To decide on the allocation of resources for this purpose, say, over a period of five years, the federal government must be provided with quantitative measures of the benefits.

Figure 1 illustrates an answer and shows:

- past experience of the accident rate (line 1 — solid),
- future forecast of the rate, excluding the effect of the plan (line 1 — broken),
- future forecast of the rate, including the effect of the plan (line 2 — broken),
- cost of the plan (line 3), and
- the direct measure of effectiveness which is the ratio of quantitative reduction in accident rate over the proposed expenditure.

By calculating this ratio, the decision-maker can be given a table that relates the ratio of accidents to the expenditure. He then is in a position to choose the level of activity that he deems desirable in the light of other activities competing for resources.

He is also in a position to assess later whether the level of activity chosen gave the results he expected, so that he can, if necessary, modify his assumptions and change his plan.

Thus, in this example, a direct measure of effectiveness can be provided.

(ii) *An Indirect Measure of Effectiveness* (See Figure 2.)

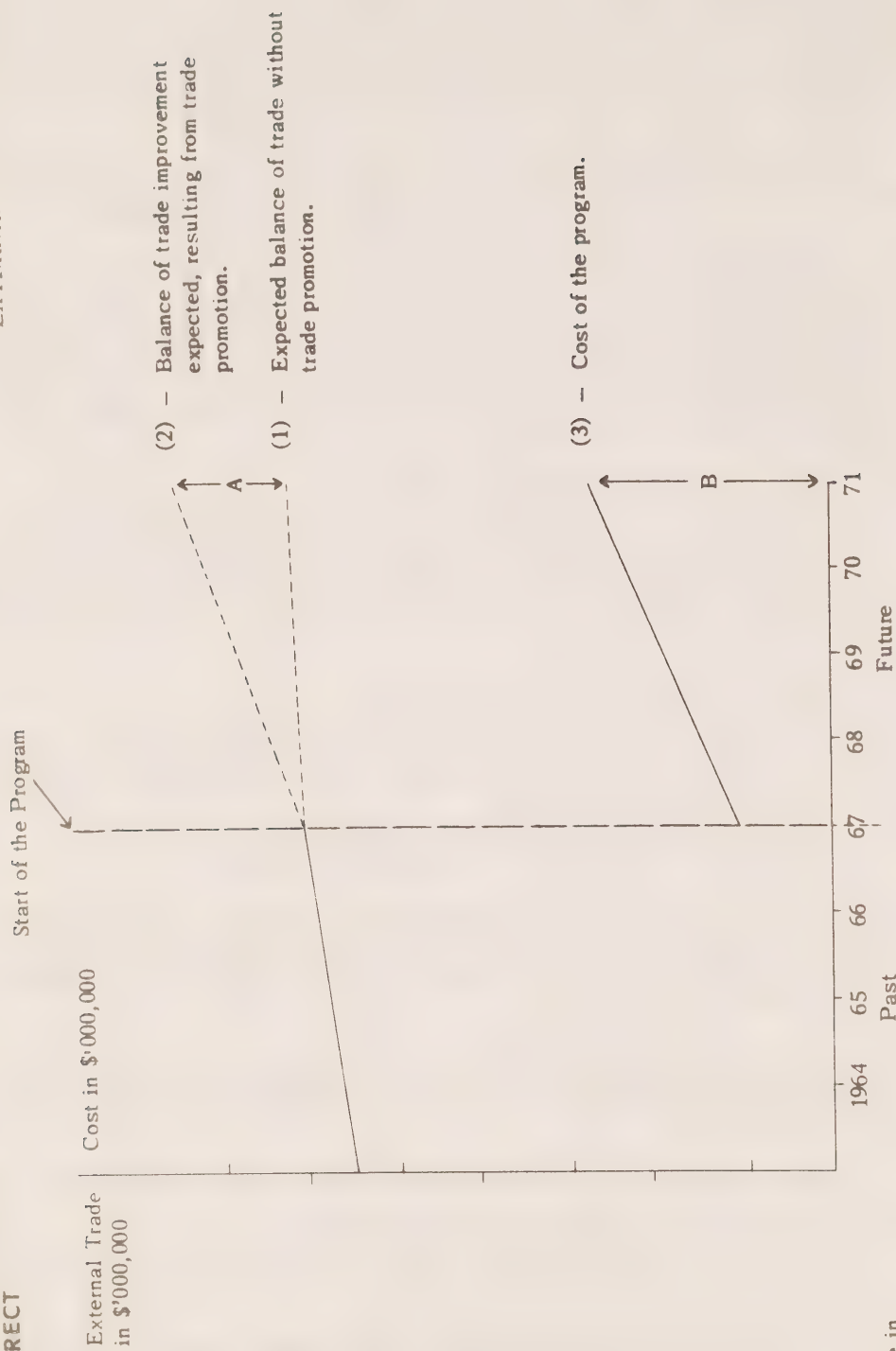
To illustrate an indirect measure of effectiveness, an over-simplified example of an activity, external trade promotion, will be used.

This example assumes that:

- The objective is to foster the health of the Canadian economy by promoting external trade.
- Direct measures of effectiveness were impossible to determine.
- The improvement in the balance of trade between Canada and selected countries satisfactorily reflects the effectiveness of this activity.
- All required resources in terms of money were included in the program review.

MEASURE OF EFFECTIVENESS INDIRECT

EXTERNAL TRADE PROMOTION



$$\frac{A}{B} = \frac{\text{Increase in Trade per } \$'000,000}{\text{Cost of the program}}$$

The ratio $\frac{A}{B}$ is an indirect measure of effectiveness.

FIGURE 2

Figure 2 illustrates this approach where the necessary indirect measure of effectiveness is the ratio of the net change in the trade figures to dollar cost of the program, that is, $\frac{A}{B}$.

This is an illustration only. It does not attempt to face and answer the tricky question of distinguishing between changes in trade quantities attributable to the promotion activity and changes that might be attributable to other causes such as devaluation of currency.

The nature and reliability of measures of effectiveness are among the considerations to be weighed by planners in analysing alternatives, the second distinctive concept in program planning.

(c) *Analysis of Alternatives*

Program planning has to be long range because the activities involved are usually spread over a number of years. Furthermore, the heaviest costs may be incurred in the later years and only a long-range plan will show the full impact of the costs. In addition, the department may have a number of activities that it wishes but is not able to perform all at once. This type of situation forces the department to analyze alternative plans in order to choose the best mix of tasks for the coming years.

Assume that the department considers it necessary to build all three highways mentioned in 2(b), each of which will meet only one of the objectives. It may well be that budgetary limitations make it necessary to build them one at a time. The department will now have to describe these objectives in detail, and prepare measures of effectiveness for the inter-urban highway, the tourist centre highway and the one to the mining area. When this has been done, everything that can be expressed in numerical terms will be in that form. At this point, with all the facts assembled, a judgment will have to be made about which highway contributes most to the total objectives of the department and therefore which highway should be built first. This is one aspect of the analysis of alternatives.

It is important to realize that this type of approach does not eliminate judgment. Judgment in a situation of this type takes into account a variety of considerations, social, economic, political, and technical. At first sight, such considerations do not appear to lend themselves to precise description and measurement using modern techniques. However, application of any of these techniques, even to a limited extent, may assist judgment by reducing some of the unknowns, so that judgment can be made with greater confidence about the advantages and disadvantages of all realistic alternatives.

Another aspect, namely the feasibility of alternatives, is shown in a still more detailed example. In the example of the three highways mentioned above, completion of each road, by a certain date, and within a certain cost, may be important considerations. If the highway to the tourist area is not ready by early summer much of its benefit will be lost. For each choice, therefore, many statistical questions will have to be considered, such as:

- What is the likelihood of an early winter that will close construction?
- What are the chances of assembling the road-building crews in remote areas?
- What are the chances of getting the steel required for bridge-building?

The answers to all these and other such questions taken together will give an indicator for each highway of how likely it is that it will be accomplished in time, and at an acceptable cost. The result of these analyses would also be used in deciding which highway to build first.

From what has been said it is clear that analysis of alternatives will be performed at different levels of the problem to serve different purposes. In the first example, it was designed to analyze which highway would be of greatest benefit in meeting the objectives of the department. In the second, it was directed towards selecting the highway which most likely would be completed to meet certain specifications of time and cost.

There are still other levels of analysis of alternatives. Suppose the department is responsible for all transport and not highways only. If the objective is to move people between urban centres, it might be done by building roads, improving airports to increase air traffic, developing more rail systems and so on. Each alternative method can be planned, provided with measures of effectiveness, and analyzed for likelihood of accomplishment. Departmental systems of planning in the future will have to be capable of producing data necessary to permit comparisons to be made at this higher level of social objectives, not only for federal government planning, but also for inter-governmental planning.

Even if there is only one way to achieve the objective, the related activities could be performed at different levels of intensity, with a fixed quantity of resources for a fixed period of time. Probably the best available technique for distributing resources in this situation is marginal utility analysis.

No mere list of decision problems, however detailed, can exhaust all the kinds of choice that might arise, but these examples may be sufficient to bring out the equal importance of the analysis of alternatives with measures of effectiveness.

(d) *Long-range Planning*

The view is often taken that under the present departmental estimates system, management prepares plans and budgets, and sets standards and measures of performance (performance indicators). Some people may think the new system described in the Program Review and Estimates Manual is nothing more than a long-range projection of what is done now. But this is not so.

The point is that the new concepts used for the program review include all these things, but go further. The review must increasingly concentrate upon the measures of effectiveness and the analysis of alternatives. These in turn will become progressively based on the use of mathematical and statistical techniques in planning. In the long run, it is the effectiveness of departmental programs in meeting objectives and alternative plans and levels of activity considered, that will be of primary interest to Treasury Board and to the government as a whole, including such planning advisory bodies as the Economic Council and the Science Council.

3. Operational Planning

When a long-range plan has been decided upon within a department, its operational content stated in terms of goals to be met at different points of time, constitutes the operational plan. Obviously this plan must be constructed from the contributions made by all operational managers. To meet this operational plan each manager must produce a given amount of work by a given time. This will require a definite amount of resources as expressed in a budget. Once he plans to do certain work, in a given time, and at a given cost, he has a performance target. It can be used by senior managers as a performance indicator (or a measure of performance) for that particular part of the operation. The manager at the intermediate level may or may not be affected by total measures of effectiveness because they usually relate more to the senior management level. But he is very much affected in his day-to-day operations by his measures of performance, for that is what he will be judged by.

In this operational planning stage, there must be concentration on the most efficient way of getting the job done. Mathematical and statistical approaches to planning such as Critical Path, PERT, and PERT/COST are often valuable in this situation. These techniques, as do analysis of alternatives and measures of effectiveness, commonly make substantial use of computers.

Efficiency requires meeting the goal to the required degree of effectiveness and at the lowest cost. This test must be used throughout the performance of the operation, as well as in its planning. Since resources are always scarce, what is saved through efficient use can be used elsewhere. The operational plan should therefore make provision for studies leading to efficiency. Furthermore, where possible, standards for performance should be developed that will allow managers to establish the amount of work to be expected from a given staff so that staff can be budgeted against workload.

4. Program and Estimates Review

Treasury Board conducts two reviews annually. The first, held in the late spring and called the "Program Review" emphasizes long-range plans and will become increasingly significant in relation to the government's growing need for reliable forecasts. Present forecasts are often inadequate in that they tend to be simple projections of the costs of the past and current year's activities, rather than the result of a careful review of future operational plans.

The program review will increasingly concentrate on departmental long-range plans. The comments made by the government at that time will provide the department with guidance about the government's long-range goals and, more specifically, guidance on short-range goals relevant to the second, or "Estimates Review."

This estimates review, to be held in the autumn, will concentrate on detailed requirements for the next fiscal year, in accordance with the Program Review and Estimates Manual.

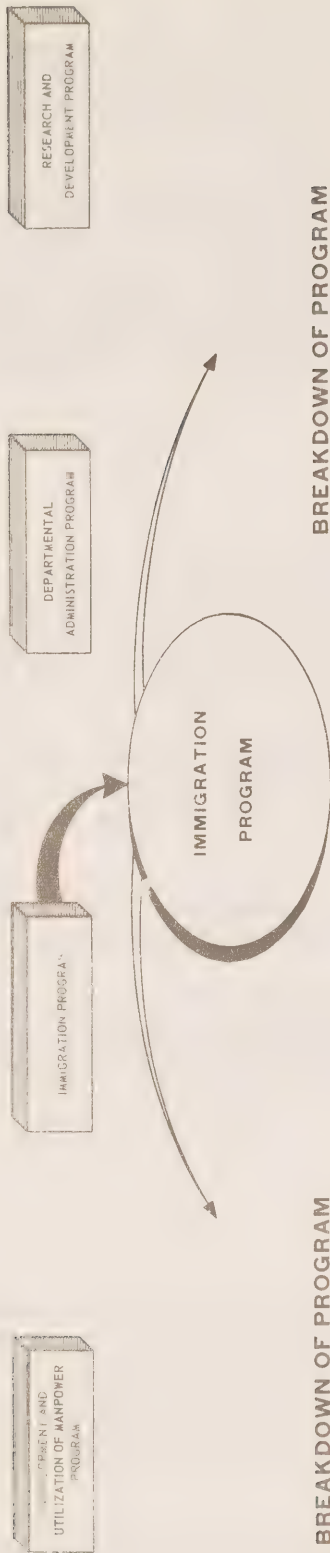
The procedure described above, leading to the production of the long-range plan, includes as the component earliest in time, the short-range plan. When this short-range plan is approved in principle at the program review, it becomes the basis for the submission for the next fiscal year presented at the estimates review.

CONCLUSION

The government at present is involved in a revision of the process of estimates to introduce progressively the basic elements of program planning into the presentation of estimates. The rate of progress from this stage to the design of more advanced measures for planning and control will depend mainly upon the speed with which a new group of planning experts can be assembled and put to work in Treasury Board secretariat. This group will, among other things, provide assistance to departments through program officers on all technical aspects of planning, but this aid lies some distance ahead.

A fully developed system of financial management must include, besides planning, a system for program budgeting, but all these developments will take time. The most important contribution to these developments that can be made in the immediate future by departmental planners and Treasury Board staff, especially program officers, is to devise appropriate structure using the family of concepts: objectives, programs, and activities. This is the subject of the next section.

ILLUSTRATION OF PROGRAM BREAKDOWN DEPARTMENT OF CITIZENSHIP AND IMMIGRATION



BREAKDOWN OF PROGRAM BY RESPONSIBILITY CENTRES

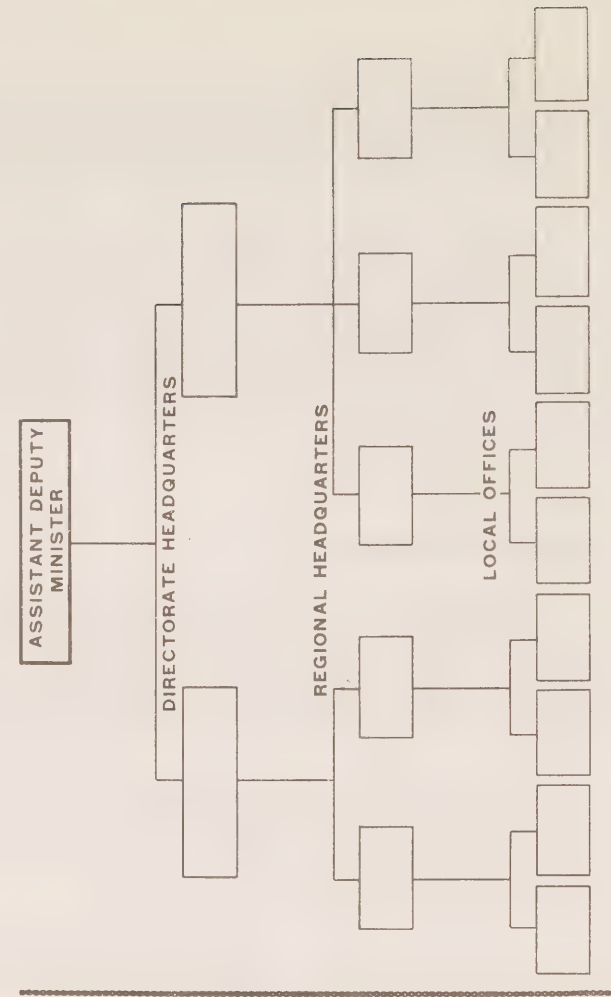
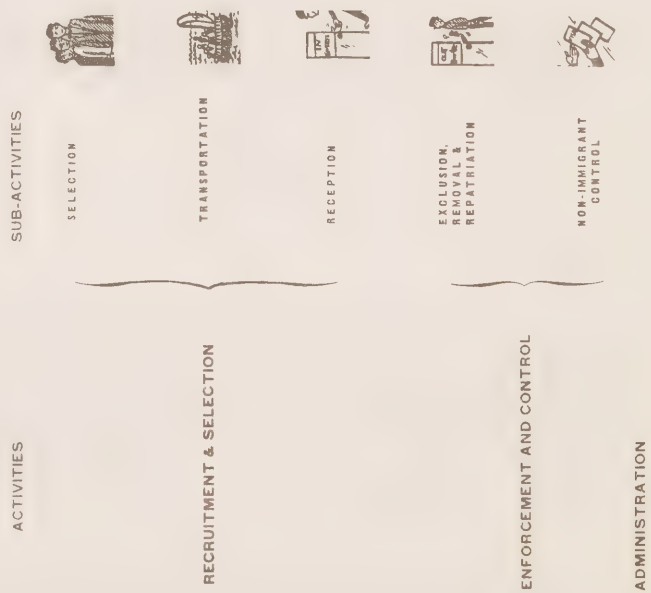


FIGURE 3

BREAKDOWN OF PROGRAM BY ACTIVITIES & SUB-ACTIVITIES



SECTION II

PROGRAMS BY ACTIVITIES AND RESPONSIBILITY CENTRES

1. General Description

In the Treasury Board policy statement on financial management (See Appendix 1.) emphasis was placed on the introduction of program budgeting to give Parliament, the executive and management a clear insight into the primary purpose of departmental operations so that alternatives could be evaluated and policy decided.

A program, for the purposes of program budgeting, is a major departmental function designed to achieve specified objectives that have been authorized by Parliament. For example, the Department of Northern Affairs and National Resources has five programs: northern program, resource development, natural and historic resources, Indian affairs, and, for budgetary purposes, departmental administration.

Although the principles outlined in this chapter are unavoidably general in character, their application is essential to achieve the broad aim of the new system of financial management, that is, the introduction of program budgeting by activities and responsibility centres.

Every program should be:

- (a) described so as to give Parliament, the executive and management a clear insight into its purpose and objectives;
- (b) authorized by legislation or an authority derived from legislation;
- (c) complete in itself so as to make possible the determination of its total cost; and
- (d) capable of assignment as far as possible to a specific person who can be held accountable for achieving its purpose.

2. Breakdown of a Program

Since programs embrace sizeable areas of government operations requiring the expenditure of many resources, they are too large to be managed effectively without further breakdown. Each program in turn has to be broken down to identify (1) the activities, indicating the kind of work done as a contribution to the realization of an accepted objective (e.g. recruitment and selection, enforcement and control, within the immigration program) and (2) the responsibility centres (e.g. particular divisions or units such as regional and district offices) indicating the organizational location and level of management that will carry out these activities. Figure 3 illustrates these breakdowns.

It is also necessary to set out the objects of expenditure that allow accounting judgments and managerial evaluation to be made at the prime responsibility centre level, that is, the centre at which the expenditure is made.

3. Breakdown by Activities

An activity in its turn will usually have to be divided into sub-activities as illustrated in figure 3. This process of division raises an important question: what are the limits in principle to the division process?

The division of activities has to go on until the last unit of the activity series describes a concrete, intended operational result: the delivery of so much mail per carrier per unit time, the teaching of the class, the safe arrival of the supply vessel with the cargo ordered, or the settlement of the right numbers of the right immigrants in the right jobs.

Departmental experience together with Treasury Board guidance will prescribe the activities and sub-activities required. The general criterion is that the final term in the division represents the smallest practical sub-division of work for the combined purposes of management: forecasting, planning, budgeting, reporting, accounting for, and controlling, operations. In particular, the cost of dividing activities should not be allowed to exceed the value of the benefits to be derived.

To summarize, an activity should be:

- (a) easy to identify in terms of work done towards an accepted objective,
- (b) related clearly to its program, and
- (c) capable of being costed, and above all carried out economically and effectively.

4. Breakdown by Responsibility Centres

Programs by activities are not self-starting and self-propelling; they can only be carried out by people organized at locations called responsibility centres.

It is here that management first reaches those decisions about what specific line operations are to be performed, by whom, and using what means, from which the rest of the management system is constructed; for example, the allocation of responsibility for work and the nature of the authority needed to do it, the kind of reporting needed for control and the accounting systems best suited to the centre. These subjects are dealt with later. The point to stress in this context is that responsibility centres are the linchpins of the whole department management system. If they break down, operational wheels cease to turn; if they are faultily fitted, the wheels will turn but inefficiently. Therefore, the most appropriate organization of responsibility centres will be tailored to carry out activities effectively and economically.

If a manager has more than one superior, he cannot be held responsible for conflicting directions. For example, if a regional or district manager is responsible to his immediate superior for a budget, but is also obliged to take direct orders from a number of staff specialists at headquarters, he cannot be held personally responsible for the operation of his unit. The organizational relations must be clarified before authority can be delegated and a responsibility reporting system initiated.

When responsibility has been precisely determined, it is essential that commensurate authority be granted to the appropriate operating manager. Budgetary control will rest on this responsibility pattern, since managers can be held correspondingly accountable for their performance only if they have the authority to manage their assigned resources.

5. Relations between activities and responsibility centres

It is obvious that the responsibility centre and the activity are separable but inter-dependent concepts. A centre may be responsible for more than one activity and an activity may be carried out by more than one responsibility centre.

Where the management organization for a program is constructed so that each organizational unit is responsible for only one activity, the program components for both responsibility

RELATIONS BETWEEN ACTIVITIES, SUB-ACTIVITIES AND RESPONSIBILITY CENTRES

DEPARTMENT OF CITIZENSHIP AND IMMIGRATION - AN ILLUSTRATION

(UNION OF THE PROGRAM BREAKDOWN SHOWN IN FIGURE 3)

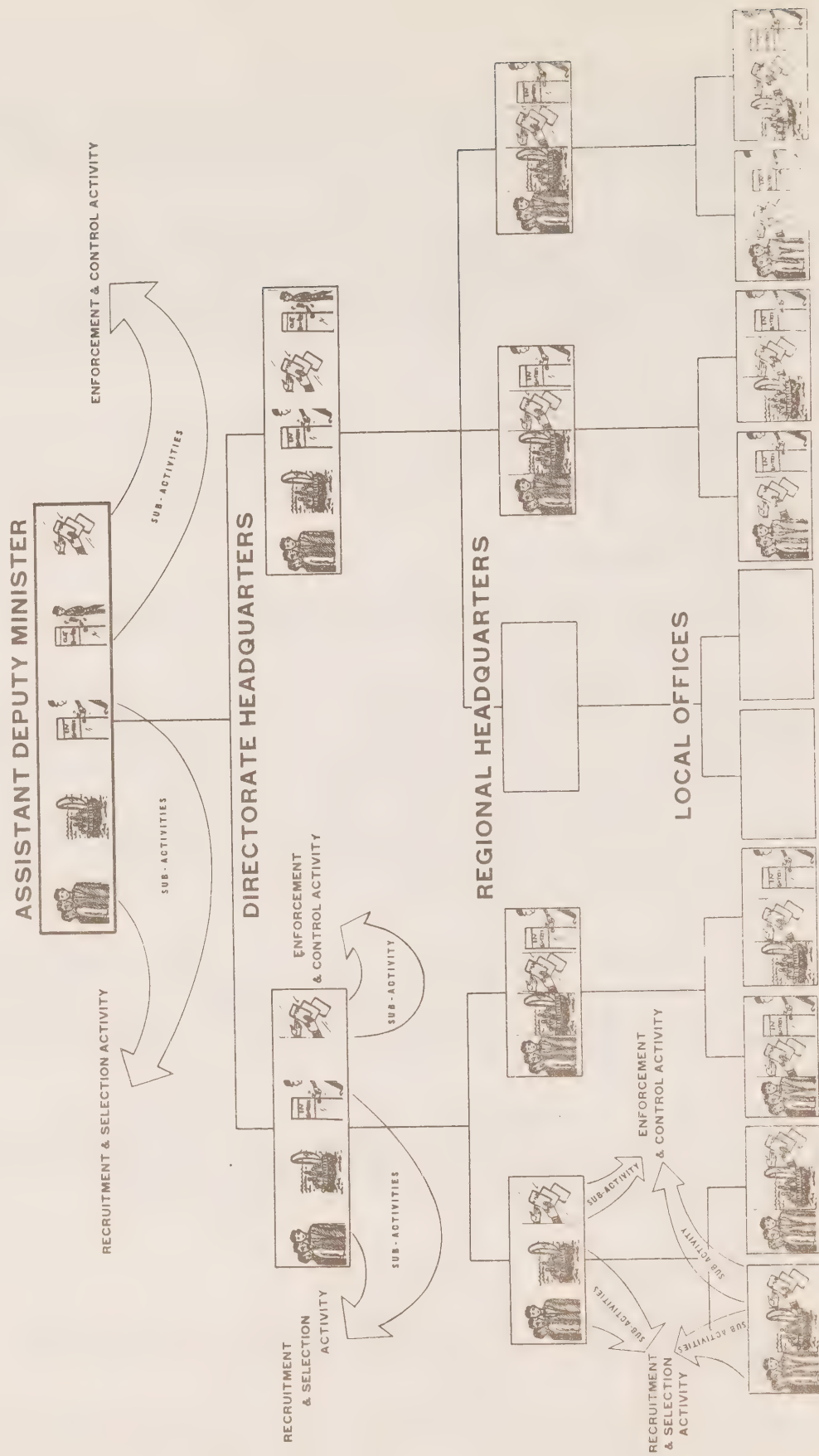


FIGURE 4

and activity reporting purposes will coincide. For example, if a program provides for the administration of the Immigration Act, and if the organization to carry out the program is separated into three divisions: (a) recruitment and selection, (b) enforcement and control, and (c) administration, with one person and his subordinates responsible for each division, then each responsibility centre is responsible for only one activity. But the program is, in fact, dispersed geographically into regions and then local offices, each of which is responsible for two or more sub-activities, thus making up two activities as illustrated in Figure 4. Therefore a responsibility centre does not always carry out only one activity.

6. Advantages of subdividing a program

The identification of activities and responsibility centres within a program enables a department to:

- (a) establish priorities among existing and contemplated activities;
- (b) weigh prospective benefits against related costs and estimate the effects of a cutback or expansion of existing programs, or the introduction of new programs;
- (c) take into account foreseeable changes in the need for services and corresponding changes in levels of operations to meet those needs; and
- (d) establish accountability for carrying out the program and for the estimate and control of expenditures and revenues associated with the program.

7. Conclusion

It should be obvious by now that descriptions of programs by activities have to be so precise and complete that management is able to select the range and kind of operations to be conducted and the responsibility centres to carry them out. However, this breakdown of a program into further and finer sub-divisions always entails a cost which has to be balanced against the expected gain in departmental effectiveness. How these selections are expressed and used in the budgetary system forms the substance of the next chapter.

Budget Preparation, Reporting, and Control

To discharge all their managerial responsibilities managers require authority to spend under an approved budget. By measuring performance against approved budgets, they can be held accountable. The first step to this end is to prepare the budget and get it approved. This is the subject of Section I. However, budgets are useful for management only if periodic reports are prepared comparing actual with planned performance. This is described in Section II. Section III is devoted to the nature and purpose of control, including the balance to be struck between the responsibilities and authorities to be given to line managers and those retained by senior management.

SECTION I

BUDGET PREPARATION

When the long-range plan has been accepted, responsible line managers have to make careful estimates of their needs for personnel, facilities and funds to implement the first stage of the plan. In short, they must prepare budgets for the operation of the units for which they are responsible. Budgets prepared in this fashion will be composed, not merely of a list of items to be paid for, but of the estimated cost of carrying out various activities within approved plans. The cost of common services now provided free to and from other departments should be included in memorandum form only in accordance with the Program Review and Estimates Manual.

1. Management's Responsibility

Actual budget preparation begins at the lowest level of responsibility and becomes progressively consolidated as it pyramids upwards through levels of management. It follows that lower levels of management cannot be expected to prepare their proposed budgets until they have been given a reasonably clear indication of the objectives and the level of operations for which they will be responsible.

In the majority of programs, where the pattern of responsibility does not correspond with the breakdown by activities, budget preparation must be planned so that financial requirements are revealed and related to both the responsibility centre and activity costs. For example, the program for Indian affairs has education as one of its activities, the total cost of which has to be reported in the budget. But, further, the total activity cost has to be broken down by the responsibility centres at which the activities are carried out.

2. Procedure to be Followed

The general guide to budget preparation is set forth below. The first step is the identification of the goals to which activities are directed and grouped into programs. Once these have been set, detailed plans have to be made specifying the required numbers and classification of people, equipment, materials, and supplies, and any other necessary resources. It follows that these physical units must then be expressed in dollars.

The following should be considered in preparing budgets by responsibility centres and by activities.

- (a) Objects of expenditure are recorded at the prime responsibility centre where the expenditure is made. This information is also required for presentation of National and Public Accounts.
- (b) As budgets are developed through the managerial pyramid, costs are accumulated by responsibility centre rather than by objects of expenditure.
- (c) The accuracy of supporting data, for example on manpower and material requirements, is essential for the activities to be carried out. This can be assured through operational planning by line management using planning and control techniques, systems and procedures analysis, and work measurement.
- (d) Fixed and variable costs should be shown separately where it would be advantageous. Where there are significant fluctuations in the volume of activities, their costs should be separated between fixed and variable, in order to determine total costs accurately.
- (e) Managers should attempt to predict as accurately as possible the time of the year in which the expenditure will be made. Although absolute precision is obviously impossible, the aim is to permit subsequent comparison of budgeted and actual expenditures. Monthly budgetary data should therefore reflect the anticipated rate of expenditure rather than a simple one-twelfth of the annual budget.
- (f) Cash requirements may differ from a departmental budget for any of the following reasons.
 - (i) If a department operates an accrual accounting system for control purposes, it will be necessary to adjust the budgetary data compiled on that basis to reflect total cash requirements for approval by Parliament.
 - (ii) The tendency of managers to forecast their requirements with contingency reserves may be offset by adjustments during the budget review process. Where objective standards have been developed, the effectiveness of the operation would tend to make this revision unnecessary.
 - (iii) In large programs the sum of separate budgets (even though each is legitimate in itself) may be greater than the historically proven pattern of actual outlays, unless adjustments are made for economies of scale or unpredictable shortfall.

For these reasons the departmental budget may have to be adjusted to ensure that the estimates represent a reasonably accurate forecast of the total cash requirements to be voted by Parliament.

- (g) Another important factor in budget preparation is commitment authority. Although commitment accounting may be delegated to departments in the future, Parliament will be interested in knowing initially the total cost of a capital project spread over more than one year, as well as approving that portion of the appropriation required for the fiscal year in question, in accordance with the Program Review and Estimates Manual.
- (h) There may be areas of government where the adoption of flexible budgeting will offer distinct advantages. Flexible budgeting may be considered as a group of alternative

budgets for various operating or volume levels. This enables management to measure the performance of their operations at different operating levels. In addition, a break-even-point analysis may be of value to departments producing non-tax revenue. Earnings can be forecast readily through flexible budgeting because, normally, at a given volume a stated return would be expected.

Flexible budgeting takes into account three kinds of costs, i.e., variable, semi-variable and fixed. It is essential in this type of budgeting to identify these costs distinctly.

This method is particularly applicable to commercially oriented operations, such as those in the Post Office Department. Other departments, particularly those producing non-tax revenues, are encouraged to study carefully the advantages to be derived from the application of flexible budgeting.

- (i) The manpower requirement for numbers of positions will be determined through the budgets examined during the estimates review and, for classifications and pay, through the system of personnel management to be established following the passage of new and revised legislation.

3. Approval of the Budget

After the budget has been prepared, it is sent to the manager's superior for acceptance and from there, after consolidation with other budgets, to higher levels of management. It might be useful to appoint a budget committee which would include the chief executive of the department, senior operating personnel and the DFMA to review the budget and recommend any necessary changes before submitting it to Treasury Board. If substantial changes in the resources to be given a manager are made during review, they obviously must be discussed with him and, where necessary, compensating changes must be made in the goals he has been given.

The same basic approach should be used in the preparation of capital budgets and budgets for grants, subsidies and other, where they exist. Capital budgets usually will be developed on the basis of specific projects.

Where revenues are significant, they should be budgeted for in the same way as expenditures so that actual revenues can be compared with expectations.

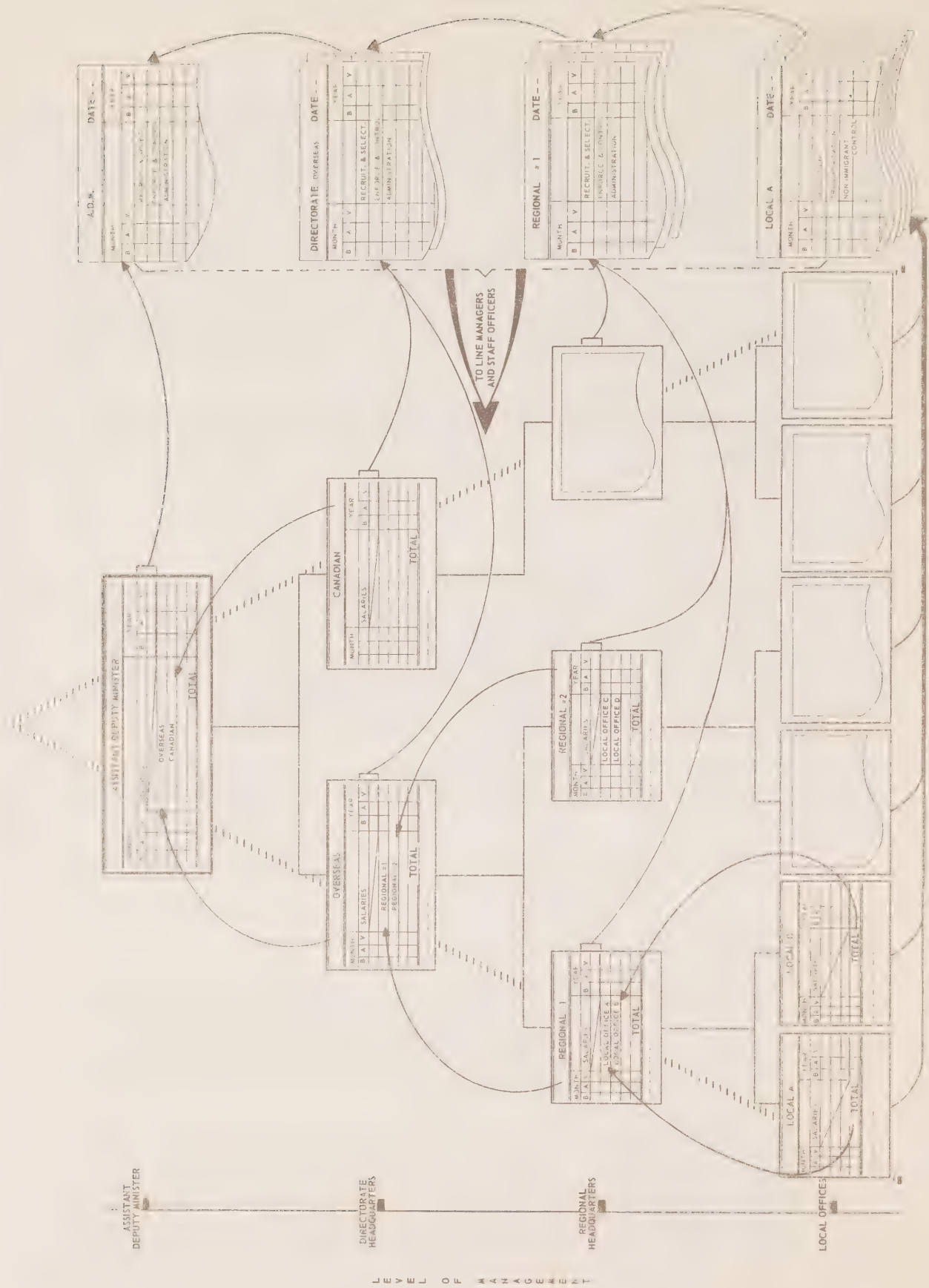
4. Budget Revisions

Operations under an approved budget will likely show that actual expenditures vary from estimated expenditures. If so, management should take action to alter operations according to the nature of these variances. Variances, whether favourable or unfavourable, might arise as a result of changes in labour efficiency, labour cost, material uses, material cost, spending volume or capacity, or combinations of these, or just poor estimating.

Managers should be given maximum freedom to offset deficiencies and surpluses in their budget if this will get the job done, provided the total budget is not exceeded and they remain within their area of responsibility. If the need for adjustment arises from inefficiencies, it is obviously important that adjustments be made in a manner that will not obscure or disguise what has happened. One method would be for the original amount to be shown in the budget, with adjustment shown in separate columns, so that managers will always be required to account for their performance against their original plans.

If, on the other hand, adjustments arise from changes in plan, the original budget figures should be altered to reflect the new situation. Departments should develop proper procedures

REPORTING BY ACTIVITIES AND RESPONSIBILITY CENTRES A GENERAL ILLUSTRATION



ST A T E M E N T O F E X P E N D I T U R E S BY ACTIVITY

FIGURE 5

governing the circumstances in which budgets may be altered. Generally, the same authorities should be required to alter a budget as were required for its original approval.

The main elements of budget preparation have now been described. Assuming that the operations contemplated in it are now proceeding, the management needs to know whether they are going according to plan. The answer to this question is discussed in the next section on reporting. As a reader will see from Figure 5 on the reporting system, reports have the same pyramidal pattern as that used in budget preparation.

SECTION II

REPORTING

Departmental reporting systems produce two kinds of reports, those required for departmental management and those required by Parliament and the executive. All reports should meet certain standards.

Representational Value – The actual results, within the boundaries of the operations reported on, must be recorded with sufficient accuracy to be truly representative of the situation.

Accountability – The individual manager responsible for achieving the results must be identified.

Comparability – The actual results must be compared on a valid basis with pre-planned objectives or standards.

Promptness – The results must be reported in sufficient time for corrective action to be taken.

Consistency – The presentation of results must be consistent for all levels of management and from one reporting period to another.

Simplicity – The results must be presented clearly and concisely with the least amount of detail consistent with the required representational value. Retrieval techniques should be used for supplementary data when they are required.

Management information is required to:

- (a) provide a control over operations, and in conjunction with workload analysis, to show the extent to which approved plans are being carried out;
- (b) facilitate the management of funds, at all times, and to show the need for supplementary estimates or adjustments of allocations;
- (c) provide a basis for the preparation of next year's estimates; and
- (d) facilitate the review of plans and priorities.

To meet these requirements, a system of reporting by areas of responsibility and by activity, as illustrated in Figure 5, must be introduced in departments.

Experience has shown that managerial reports providing historical information on actual expenditures, without a comparison to pre-determined estimates based upon approved plans, are generally inadequate for control purposes. In many departments this is the type of report that is presently available and managers are not being made aware of costs either regularly or promptly, nor are these being compared with approved plans.

Management reports should be provided regularly, usually on a monthly basis, and should show both actual and budgeted expenditures for the period in question and for the year to date. Weekly, and even daily reports, might be required for certain types of data. Statistical workload or other operational data should be prepared where necessary, since such information may prove very valuable to a supervisor in assisting him to analyze variances.

1. Reporting at the Responsibility Centre Level

In a good reporting system, separate reports become progressively consolidated as they pyramid upwards. A subordinate's performance, for control purposes, need be reported in total only. However, it may be advisable to include other statistical data, such as data from workload analysis. Higher levels of management are freed from extraneous detail and need only intervene when significant variances from plan are highlighted. Since unfavourable variances at any one level are automatically reflected upward, there will be a positive incentive for immediate supervisors to take corrective action at the earliest possible moment.

Where the accounting for a program includes accrual features, the reports would be on the same basis and show the actual use of resources rather than the payments the manager has made. Similarly, revenues, where they are included in budgets, should be recorded in the management reports.

The flow of control reports by responsibility centres is illustrated in Figure 5.

2. Reporting at the Activity Level

The discussion so far has described reports for each responsibility centre, but comparable reports are required by activity where this does not coincide with the responsibility centre. It is only on the basis of these activity reports that senior management and other levels of responsibility will be able to monitor and manage the programs in relation to plans. The flow of activity reports is also illustrated in Figure 5. When several managers have to report from their respective centres on their contributions to an activity, such as the recruitment and selection, and enforcement and control, within the immigration program, the cost control reports by responsibility centres might show only that each manager was operating within his budget. Activity reports on the other hand will enable senior managers to determine whether expenditures for the activity were equal to, greater than, or less than, the amount provided in the plan, and so to decide whether corrective action would be appropriate. As in responsibility reporting statistical data may be useful and included in the reports.

3. Cash Control Reports

Senior management must also be aware of cash requirements to the end of the fiscal year, so that they can foresee the need for additional funds at an early date, and either seek approval for supplementary estimates or alter program spending to avoid over-expenditure.

The Comptroller of the Treasury also needs to be kept informed of these requirements to provide meaningful cash forecasts to the Minister of Finance in such form as may be necessary.

Another reason for a cash management reporting system is that although, as described in Section I, normally the budget is identical with the estimates tabled in the House of Commons, this situation is not necessarily true of all departments. In some cases, it may be necessary to reduce the departmental budget in order to arrive at the parliamentary vote or the total cash requirement. This should not be confused with vote netting dealt with in Section III of this chapter.

The DFMA, as manager of the cash, will review his departmental cash position taking into account the availability of funds from the government. He should be ready to advise his deputy minister where a curtailment of expenditures is necessary.

4. Reporting for Public Accounts

The Public Accounts are a means of reporting to Parliament and the public on the financial stewardship of departments and the executive. The reader should refer to the following sections of the Financial Administration Act for guidance: 22, 23, 36, 60, 64, and 98.

In addition to the reports published under the Financial Administration Act, other statements are included in the public accounts for information purposes, such as outstanding accounts receivable.

If the accounting function is delegated to a department, the Comptroller of the Treasury will continue to specify the information required to prepare the Public Accounts.

SECTION III

CONTROLS

As an organization grows larger, it becomes necessary to delegate management duties to lower levels, even though senior management retains complete responsibility.

Allocating spending authority is one means by which responsibility may be assigned to lower levels since a manager is normally free to spend funds allocated. Control is thereby imposed at the same time because a budgetary allocation is itself a limit on the total amount that may be spent. A manager may not, however, be given unrestricted authority to spend his budgetary allocation because delegated authority may be controlled by other restrictions, for example, Government Contract Regulations and certain personnel regulations. The problem for senior management is to strike the right balance between responsibilities and authorities to be given to line managers and those to be retained.

1. Objectives

To decide what that balance is, the department should first note that the objectives of financial control are to:

- (a) achieve a high degree of responsiveness to local conditions, and the flexibility to adjust to changing conditions and unforeseen developments within approved programs;
- (b) simplify administration generally and reduce paperwork and delay by delegating authority for decisions to the lowest possible level;
- (c) place responsibility at the level where control is most effective and on officers who can be held accountable for results;
- (d) foster a greater sense of financial responsibility and an awareness of the financial implications of management decisions at the local level;

- (e) encourage active participation by senior program personnel in the financial management of their programs;
- (f) provide an environment that will encourage and assist managers to make the most effective use of available resources; and
- (g) assure senior management that the organization is moving in the right direction and functioning properly as it goes.

Appreciation of these objectives requires a further account of what financial control really is. In the past, financial control has been limited mainly to systems designed to prevent illegal or other improper payments. By contrast, in a system of program budgeting, approved budgets of authorized programs are used by management to guide the operations toward approved and specified goals. Methods of doing this are discussed in chapter VI. Controls are not road blocks, but road signs, as the following description of them should make clear. It will cover:

- Allocation of Spending Authority
- Delegation of Authority
- Control by the Budget
- Revenue Control
- Pre-audit
- Vote Structure

Commitment control and cost accounting are discussed in chapter VI.

2. Allocation of Spending Authority

Since Parliament's scrutiny of the estimates usually takes several months, the government's requirements for spending authority are met initially by interim supply bills. With the approval of the estimates by Parliament at a later date, complete allocation of spending authority is thereby granted. The manner in which requests for this parliamentary authority are to be prepared has already been described: the preparation of budgets based on plans at the lowest accountable level, the consolidation of these budgets into estimates for each program by votes, and the review by Treasury Board.

The general conclusion that present methods of allocating spending authority are unduly restrictive has been accepted. In approving the consolidation of votes that occurred in the estimates for 1964-65, Parliament already has substantially reduced the number of appropriations.

In the past, allotment controls proposed by departments have tended to be on the basis of objects of expenditure, with the emphasis being placed on how funds were spent rather than why. Operating managers could seldom be held accountable since the authority to incur expenditures from each allotment had not been vested in responsible managers.

To correct these anomalies, control through the allocation of spending authority should follow the same pattern of responsibility applied in the preparation of estimates. In other words, the pyramidal structure used to compile and approve the budget, upward, should be used to allocate, downward, the spending authority.

Once given an approved budget, a manager should also be given the greatest possible freedom to spend within it. Control should be achieved by monitoring performance and not by restricting freedom to act.

3. Delegation of Authority

The principal method of delegating authority should be the allocation of spending authority by a budget. Recent experience has shown that there are often weaknesses in patterns of delegation. Therefore, the successful introduction of program budgeting and responsibility accounting will necessitate a careful review of present practices in all departments.

In conducting such reviews these considerations should be taken into account.

- (a) Delegated authority should reflect the organizational structure required to carry out the activities of a program.
- (b) Authority to make expenditures should be related to the total of the manager's budget and, within this, be as broad as possible.
- (c) Delegation should be extended downward progressively from level to level in order to ensure that no more than one person is given authority for any one budget. If two people are responsible for the same thing, then one is surely redundant.
- (d) Transfer of pay list items to other purposes or vice versa should be approved by the next higher level of management.

The system of delegated authority will result in an adequate system of financial accountability only if:

- (a) all managers recognize that they are accountable for their performance to their superiors;
- (b) delegated authorities are communicated simply and directly to all levels of management by policies, procedures, regulations, and manuals of instruction, all of which should be kept up to date; and
- (c) both the person delegating authority and the recipient understand:
 - (i) the nature and extent of the delegation that has taken place; and
 - (ii) the means of control that will be used.

The basic criteria for delegating authority are the nature and size of a manager's operations, the existence of external controls imposed on him by authorities other than his immediate superiors, and finally the individual's qualifications for making decisions.

4. Control by the Budget

The allocation of money by Parliament to the Crown and thence to the department and its distribution throughout the department constitute the first element of control. For this control to operate successfully, authority to spend the funds must be delegated to the recipients of the funds. It is in this context that budgetary control makes its contribution to the total system by providing the yardstick against which actual operations are judged.

5. Revenue Control

For the present purpose, revenue refers to non-tax income from sources outside the government. Problems of interdepartmental transfers for common services, although similar in some respects to non-tax income, are now being studied in Treasury Board and further guidance will be given when the study has been completed.

Responsible financial management requires the application of controls over the collection of revenues as well as over the expenditure of funds. In the present system of financial control, insufficient attention is given to revenue. There is a lack of uniformity in the manner in which revenues are handled and recorded. The collection of revenue has often been considered as a routine accounting function, and many line officers divorce themselves completely from any responsibility for revenue. Moreover, since many potential sources of revenue are now overlooked, it is not surprising that revenue rates bear little relation to costs.

Management must assume full responsibility for developing additional revenues from existing sources, and ensure that action is taken where necessary to force payment of outstanding accounts. A Management Improvement Policy No. MI – 4 – 66 on Revenue and Accounts Receivable Control is included as Appendix No. 2 and should be referred to for additional information.

Although there is a need for improvement in accounting controls, much of the present weakness stems from a failure of management to assume proper responsibility for ensuring that appropriate charges are made and collected, and that controls exist. Departments should therefore review their procedures in the light of these principles.

- (a) Revenues associated with expenditures in a vote should be disclosed in the estimates, even though appropriations are on a gross basis. Treasury Board may require in some instances that revenues by activities be shown.
- (b) Responsibility for revenue control should be placed at the point where the service is rendered by the inclusion of estimated revenues in budgets for responsibility centres.
- (c) Wherever economically and administratively feasible, a charge should be made for all services rendered or goods supplied to the public unless specific exemptions have been laid down by statute. It should be noted that in the absence of statutory authority authorizing a department to fix such charges, approval must be obtained from the Governor in Council pursuant to section 18 of the Financial Administration Act.
- (d) Charges should at least cover all direct and indirect costs of providing the service except where otherwise provided by statute or the Treasury Board. Regular reviews of the adequacy of charges should be made.

6. Pre-Audit

Under the British North America Act, no payment shall be made out of the Consolidated Revenue Fund without the authority of Parliament. Authority is given through the annual appropriations or other statutes, particularly the Financial Administration Act, which provides the major part of the legal basis for financial control in the government.

Under the present law, the Comptroller of the Treasury conducts the pre-audit. It is designed to ensure that:

- (a) expenditures are charged to the proper vote and allotment;
- (b) no vote or allotment is exceeded;
- (c) relevant statutory authorities, all regulations and directives, as well as departmental rules and regulations, are observed; and
- (d) mathematical accuracy of requisitions for payment, evidenced by supporting vouchers, is verified.

In brief, Treasury officers oversee all departmental expenditures to ensure that the rules of Parliament, the central control agencies, and the departments themselves are obeyed.

The Glassco Commission considered that the pre-audit function resulted in an excessive amount of repetitive checking that tended to dilute the sense of responsibility in the department, and recommended that these responsibilities be transferred to departments. This recommendation is now under review and, in keeping with the underlying principle that departments should account for the management of the financial resources placed at their disposal, they must continue to assume responsibility for determining that:

- (a) expenditures are proper charges;
- (b) expenditures comply with all statutes, rules and regulations; and
- (c) funds are available within approved budgets.

This responsibility is not restricted to payments for goods and services, but extends to other payments such as payroll and those of a repetitive nature.

7. Vote Structure

The vote structure itself imposes elements of control. The manner in which programs by activities are divided into votes is dictated by the needs of parliamentary review and control.

(a) *Division of Votes*

The drawing together of all the costs of any program would suggest that one program equals one vote. However, most programs contain both operating and capital expenditures; many also have major transfer payments (grants and subsidies). These three elements are important on a government-wide basis. Trends in operating costs should not be obscured by the year-to-year fluctuations that occur in capital programs. In addition, Parliament and the executive have a special interest in the effect of capital programs on the economy, and the flexibility to adjust these programs in response to economic circumstances is of particular importance,

Each program will continue to be divided, where appropriate, into the three votes:

- (i) Operation and Maintenance,
- (ii) Capital, and
- (iii) Grants, Subsidies and Other.

A capital expenditure, so classified through the proper objects of expenditure coding, shall be voted separately from the other votes if the aggregate of the total items is in excess of \$500,000. A study is now in hand to identify the items of expenditure that will be classified as capital. Further direction on this subject will be issued.

(b) *Vote Netting*

The Glassco Commission recommended that, where appropriate, revenue be offset against related expenditure, and that votes be shown in the estimates and controlled on a net basis. It noted that the normal control exercised by Parliament is on gross expenditure, and revenues are not available to cover further spending. As a result, departmental management has had little incentive to collect a fair price for a particular service, even where a reasonable charge would not interfere with the purpose of the service. Furthermore, because expenditure has been controlled without regard to related revenue, management has not been in a position to increase expenditures to provide increased services, in response to demand and the willingness of the public to pay.

Vote netting would:

- provide management with greater incentive to improve service and to collect the revenues thus generated;
- allow a department to adjust its services to meet changes in demand, with no

- change in the amount voted by Parliament; and
- provide a clear test of the real importance the public attaches to the service as evidenced by their willingness to pay.

On the other hand there may be disadvantages in vote netting, such as curtailment of a program or activities because of:

- short-fall in anticipated revenues;
- delay in receipt of monies for services provided; and
- restrictions on available funds in the early part of the year when expenditures are being incurred but revenues have not yet been generated.

If vote netting is, in fact, to be useful, it follows that revenues generally should:

- (i) be directly associated with expenditures for an activity in the estimates;
- (ii) be derived from services provided on a regular basis;
- (iii) vary directly with the related expenditures for the service;
- (iv) be capable of reasonably accurate and annual prediction; and
- (v) be of sufficient magnitude to warrant the separate controls that would be required within a program.

The recommendation of the Glassco Commission on vote netting has been accepted in principle but no general policy has been established as yet. Departments should review their positions in the light of this guide taking into account the alternative of using working capital advances.

(c) *Working Capital Advances (Formerly Revolving Funds)*

Use of these advances requires parliamentary sanction and therefore may affect vote structure. Following a study on this subject, Treasury Board has issued a Management Improvement Policy included as Appendix 3. Departments should familiarize themselves with this policy statement and decide whether they have a need for this device to improve their financial management system.

CONCLUSION

The controls described above represent, in the main, departmental contributions to the new systems. Treasury Board will continue to exercise a measure of control over allotments but, in support of the new policy to give progressively greater autonomy to departments, it will adjust its control to the progress made by departments in introducing the concepts of this guide. However, this control will not necessarily be by objects of expenditure.

Accounting Systems and Operations

So far the guide has taken for granted the existence of accounting systems in the management cycle for planning, budgeting, and reporting. This chapter is devoted to describing the main elements in such systems, designed to meet the two major requirements of the Government of Canada. First, accounting systems have to enable the executive and statutory authorities such as the Minister of Finance, the Comptroller of the Treasury, and the Auditor General to discharge their responsibilities to Parliament. Second, the system has to provide departmental managers with the means of planning, budgeting, and control. In other words, a modern accounting system for financial management is essentially an information system about the past, present and future, and not merely an arithmetical record of the ins and outs of voted money and revenues.

Although the degree of complexity of the accounting systems will vary considerably from department to department, depending in part on the complexity of operations, an acceptable system should have these characteristics.

1. Be simple in execution. A system that is more elaborate or complicated than required will be inefficient and cumbersome.
2. Be capable of providing meaningful, reliable and timely information. If the reports are to be of value to managers, they must be dependable, current and prepared promptly, preferably within one-fifth of the working days in the reporting period.
3. Be consistent in presentation with the system used in other departments. To avoid a multiplicity of incompatible systems guidance should be sought from the accounting advisory services of the Comptroller of the Treasury.

To decide what innovations are needed, departments should consider the following subjects:

- Allocation of Responsibility for Accounting
- Coding and Classification of Accounts
- Fiscal Accounting
- Commitment Accounting and Control
- Accrual Accounting
- Cost Accounting
- Common Services
- Internal Accounting Control
- Interpretation
- Mechanization
- Assistance and Advice

1. Allocation of Responsibility for Accounting

Under Section 5(3) of the Financial Administration Act, Treasury Board is responsible for prescribing the manner and form in which the accounts of Canada and of the several departments are to be kept. In dealing with advice issued from time to time by Treasury Board, the department has the responsibility for determining what records are to be kept, what reports are to be prepared, and the dates on which such reports are to become available. Before undertaking its own accounting functions a department should weigh carefully the administrative costs and the benefits expected against those of continuing the present system. If a department decides to perform its own accounting function, the following criteria should apply.

- (a) Adequate internal controls exist to safeguard the government from illegal or other improper financial transactions.
- (b) Greater efficiency and economy would be achieved.
- (c) The accounting system meets the requirements of the Comptroller of the Treasury for:
 - cheque issue
 - the preparation of Public Accounts
 - fiscal accounting for the Government of Canada
 - commitment control
 - pre-audit of expenditures and
 - cash management.

Where authority for accounting has been delegated to the department, it may be withdrawn by Treasury Board if it is deemed to have been used contrary to good practice, but until decisions to delegate are taken, the Comptroller of the Treasury will continue to perform accounting functions as at present. It is expected that many departments will continue to avail themselves of the services of the Comptroller of the Treasury. However, where such services do not meet departmental requirements, the matter should be discussed initially with the comptroller and then referred, if necessary, to Treasury Board for further consideration.

2. Coding and Classification of Accounts

Accounting codes have been described as the “wiring-network” of the accounting system. If this wiring-network is not designed with a clear understanding of the needs of the users, gaps and overlapping in reporting will inevitably occur.

A satisfactory coding system is needed for the internal accounting systems of departments and for the compilation of the National and Public Accounts.

Within each program, expenditures and revenues may be classified in four ways:

1. by purpose, i.e., the activity or activities in which the responsible unit is engaged;
2. by source, i.e., the organizational unit responsible for initiating the expenditure or providing the service from which revenues are obtained, i.e., responsibility centres;
3. by object of expenditure, i.e., salaries, travel, material, etc., and
4. votes as described under Vote Structure, Ch. V, Section III, sub-section 7.

A classification of expenditures by object has existed for many years, and indeed has been the primary classification of most accounting systems. Such a classification is essential under any accounting system, and in government is the necessary means of bringing the total accounts of all departments and agencies together on a common basis.

In most departments, however, financial reports, prepared on the basis of either responsibility or activity, have been of secondary importance to reports on an object basis. It should be apparent by now that the requirements of the whole system of financial management can only be met if the coding system permits the recording and assembling of expenditures and revenues by responsibility and activity as well as by object of expenditure. All this information can readily be made available through an appropriate revision of the codes of accounts. Such a revision is now being undertaken on an interdepartmental basis. The Interdepartmental Committee on Expenditure Coding has made certain recommendations in its report, and after decisions have been made by Treasury Board, appropriate instructions will be issued.

3. Fiscal Accounting

Since the prime purpose of government accounting is to serve the requirements of Parliament, and since parliamentary control in Canada is predicated on the operation of the Consolidated Revenue Fund, which is by law a cash account, it follows that the accounts are maintained on a cash basis. Although revenues are reported on a cash basis, there are accrual accounting implications in the provision under section 35 of the Financial Administration Act for bringing into the accounts of each fiscal year expenditures relating to that year, which, on a purely cash basis, would be excluded.

For further information see Appendix 4 on Fiscal Accounts.

4. Commitment Accounting and Control

(a) General

Commitment accounting on a centralized basis was first introduced in 1931 to remedy serious shortcomings in departmental accounting records. There can be little doubt that the system succeeded in correcting the abuses that led to its establishment. Rarely since then have departments overspent their authorized cash resources. Commitment accounting is essentially the recording of an obligation at the time it is foreseen, not at the time it is incurred.

The existing system of centralized commitment control, whereby the recorded total of funds in an appropriation is progressively reduced by the estimated amount of each actual or potential liability (e.g., purchase order or other contract), even though cash payment is not immediately required, clearly provides a control against over-expenditure of appropriations.

Within a centralized commitment system, certain undesirable consequences do result. When several officers have authority to incur expenditures from a single budgetary allotment, the tendency to lapsing of funds increases. Officers can reserve funds to meet their own specific anticipated requirements by establishing commitments, thus tying up funds, perhaps unnecessarily. Since a history of lapsing funds raises doubts as to the quality of estimating, the tendency is to centralize expenditure authority which, in any large operation, is inimical to good management.

(b) Operation and Maintenance

The adoption of program budgeting by activities and responsibility centres will obviate the need for the existing unduly complex systems of record keeping. Under an efficient system of budgetary control, each responsible manager has readily available the most useful and simple record he needs: a file of open requisitions. When the manager certifies that goods or services have been received, he will have the information required to clear his open file. The same principle could be extended for other obligations of a service nature or of a statutory character.

Over-expenditure will be prevented when each manager lives within his budget. An adequate reporting system, requiring each manager to forecast budget expenditures quarterly during the early part of the year, and monthly during the last quarter, will minimize the lapsing of funds. For the year-end period a simple memo record system may be maintained for each responsible manager, which could operate in the following general fashion.

- (i) To the responsibility reports received in January, February, and March would be added known fixed or recurring expenditure for the remainder of the fiscal year, such as salaries and utilities. Also added would be any amounts outstanding on purchase orders for which the corresponding invoices had either not been received by the department or had not been processed by the treasury officer at the time the expenditure statement was prepared.
- (ii) These amounts, when subtracted from the total corresponding budget, would give the free balance of funds. This free balance would be reduced every time a new obligation was incurred during the month.
- (iii) The up-to-date free balance would be calculated each time a subsequent responsibility report is received. Since the Financial Administration Act has not been modified, departments should assume their responsibilities in controlling the expenditures under each program and within each vote. To this end, the use of "blanket" commitments should be extended in co-operation with the Comptroller of the Treasury.

(c) Capital

Because of uncertainties associated with large capital projects, funds will usually be controlled by head office through a separate capital budget, and only the funds required for smaller projects will be included in the budgets of lower levels of management. Many capital projects and the related contracts cover several fiscal years. When such a contract is entered into, funds are committed not only for the current year but also, on a memorandum basis, for subsequent years. As the year draws to a close, the current year's commitments are kept under review, and some may be deferred to the following year when work is falling behind, while others are advanced from future years when work is accelerated.

When a contract extending over more than one year is approved, there is an implicit promise to provide funds when required in future years. When authorized by Treasury Board, commitment control for capital votes will be on multi-year basis to show the true amount of commitment that must be honoured in any one and in all years, and the accounting system should be designed accordingly.

5. Accrual Accounting

Accounting transactions may be recorded in the following ways.

- (a) Commitment accounting –
when the need to purchase goods or services is realized and a requisition is issued.
- (b) Cash accounting –
when the goods or services are paid for or revenue is received.
- (c) Accrual accounting –
when the goods or services are consumed, whether or not they have been paid for, or when revenue is earned.

The central accounting system of the government is basically on a cash basis. Accrual accounting, advocated by the Glassco Commission for extensive use, has been found in subsequent detailed studies to have many advantages; however, it should not be introduced where cash accounting is adequate for management purposes.

The information provided by accrual accounting is more meaningful to managers of an undertaking where there are delays, on the one hand, between the payment for and consumption of goods and services and, on the other hand, between the earning and receipt of revenues. In operations where these delays are comparatively short, adequate information will be available from the reporting system, particularly when significant stores operations are financed by working capital advances.

Accrual accounting has a direct bearing on both revenues and expenditures.

(a) Revenues

For many departments there may be little to be gained by abandoning the cash method to record revenues except where the revenues are credited to working capital advances. Some of the reasons to support this conclusion are as follows.

- (i) In absolute terms, non-tax revenues are substantial, but in relation to most expenditure budgets may represent a small percentage.
- (ii) Accounts receivable tend to be insignificant as a percentage of total non-tax revenues. This indicates that revenues are collected shortly after they are earned.
- (iii) In many instances, the revenues collected bear little relation to the expenditures.

There are instances where revenues are earned well in advance of receipts, for example, the storage of grain in Canadian government elevators. In such cases, modifications should be made to the accounting system to report accurately what has actually occurred during a given period. In addition, certain large-scale commercial operations, such as those of the Post Office, will undoubtedly require the introduction of accrual accounting if the reports are to be meaningful to management for control and decision-making.

(b) Expenditures

(i) Salaries and Wages

In many programs throughout the government a large portion of expenditures is represented by salaries and wages. In such instances, accrual accounting for expenditures has limited application.

(ii) Material

Although there are some factors that may cause unpaid or uncollected accounts to fluctuate, these can be generally remedied by good management. By contrast, good material management is likely to lead to fluctuations in inventory levels, not necessarily even them out.

Quantity buying, seasonal buying, and physical supply factors dictate the timing of inventory replenishment. Consumption, on the other hand, will vary with the level of activities being carried on. Thus, since it is not only normal, but good management to have fluctuating inventories, financial statements will be of little value to operating management if they report cash disbursed instead of goods consumed. In most instances, this requirement can be met by placing inventories under working capital advances so that withdrawals from stores can be charged

against the appropriation account and the management's budget at the time the withdrawals are made. (See Appendix 3 on Working Capital Advances.)

The main weakness in the present stores working capital advances is the incompleteness of their coverage. Most of them finance only major stocks where the inventory is under close physical control. The large inventories of spare parts, material and supplies, and stationery and office supplies, which are held in reserve at most operating locations, are often not covered by a working capital advance. Such items have been charged as expenditures, and therefore, even though they may be under good physical control, accounting control is non-existent. These stocks can be used improperly to even out unfavourable financial reports and to avoid the impact of government economy measures. Thus financial control is also weakened. It is apparent that the scope of present working capital advances should be extended to cover all but small operating supplies. Accounting for inventories would then be on an accrual basis.

(iii) Depreciation

A system of accrual accounting for expenditures normally includes depreciation accounting because it is a means of allocating the cost of capital assets to those periods in which the assets are used,

Depreciation must be calculated for purposes of rate setting and make-or-buy decisions, and this can be done without setting up an accrual accounting system for depreciation. In such cases full details must be available on the cost of the capital facilities for which the department is responsible, including those provided by other departments.

(iv) Conclusion

Where statements of cash disbursements are completely inadequate for management purposes, departments should consider adopting accrual accounting, bearing in mind the costs against the benefits to be derived. It should be apparent that the more closely an operation resembles a commercial or industrial undertaking, the greater will be the need for accrual accounting. Departments should then carefully examine their operations and develop the improvements that are appropriate, remembering that the ultimate government accounting system is on a cash basis and any deviation requires a reconciliation.

6. Cost Accounting

Control over expenditures is exercised as described above in the budgetary system. Cost accounting within that system is used first to provide the basic costing data for preparing the budget, second as a control on expenditures, and finally for decision-making. The major ways of using cost accounting are described below.

(a) Historical and Standard Costs

One of the objectives of cost accounting is to determine the cost of producing a unit of product or the rendering of a unit of service. To achieve this it is necessary to accumulate cost data in a certain fashion, and a decision must be made whether the historical or standard approach should be used. Departments, therefore, should study their requirements and make the appropriate choice.

Increasing or decreasing trends in costs can be detected through the use of historical costing, but the efficiency of management remains unknown since no precise targets or

standards are available for comparison with actual costs. Although certain government operations may be susceptible only to historical costing, a standard cost system on the other hand:

- (i) provides greater accuracy in planning and controlling;
- (ii) facilitates the preparation of budgets;
- (iii) predetermines the cost of a plan or project;
- (iv) simplifies the costing procedures;
- (v) introduces a yardstick to measure the performance;
- (vi) simplifies the valuation of inventories and stabilizes the recorded material costs;
and
- (vii) permits a variety of analyses to calculate and set the rates for goods and services.

Since standard costs represent the desired costs to be incurred, deviations of actual costs from standards will indicate the degree of efficiency in an organization. Variances are computed when comparing actual to standard costs to facilitate effective analysis, and to expose the areas deserving attention.

A standard costing system is particularly applicable to repetitive and large – volume operations. Standard costing combined with a budgetary system offers the best combination for assisting management to control operations.

(b) Job Order and Process Costing

The previous discussion described two approaches to cost accounting, historical and standard. This section deals with the alternative ways of applying these techniques. One is job order cost where costs are accumulated by lots or jobs, as opposed to process cost where costs are compiled by processes and averaged over units produced. The type of operation of an organization will determine which is the appropriate one to adopt. Frequently an organization uses both. At the Canadian Government Printing Bureau job order costing is largely used for printing, because each job is normally made to order; but process costing is also applied, especially at their field plants, where costs are determined and recovered on a unit of production basis.

(c) Unit Cost Control

Through the application of costing techniques, unit costs should be developed, wherever practicable, to establish the cost of performing a service or producing certain goods. These unit costs can then be compared with standard, or with unit costs of prior periods or those of other organizations, to provide a measure of efficiency in providing the service.

The unit cost approach, either standard or historically based, may not always provide the most appropriate type of control, for example, where labour costs comprise a large portion of total administrative expenditures and the same personnel are involved in a variety of operations which would be expensive to cost individually. In such instances, workload analysis, including work measurement, would probably provide sufficient information for budgetary control and performance appraisal purposes. For pricing or make-or-buy decisions, cost accounting techniques should be applied to meet the needs of each department.

(d) Conclusion

Costing information is now often incomplete. Unit costs should be made available wherever possible. All significant items, such as the costs of common services should be included on a memorandum basis. In addition, management will, from time to time, require more refined costing data than are normally available; for example, when considering the expansion of government-owned capital facilities, make-or-buy problems, or setting price levels for the supply of goods or services.

7. Common services

To determine the appropriate degree of costing required, consideration must be given to the handling of the costs of common services. These services can be generated within or outside the department. Unless these are taken into consideration, a realistic evaluation of the costs of various operations is not possible and the officers concerned cannot be held accountable for all the costs incurred by their operations.

Examples of such costs within a department are overhead or support items such as headquarters and field administration, or services such as shop work, transportation and communications, provided by one program or activity in support of another.

Costs originating outside the departments usually fall into such categories as accommodation, accounting and cheque-issue services, employee fringe benefits (superannuation contributions, surgical-medical insurance premiums and compensation payments) and carrying of franked mail.

Other costs, such as interest on capital investment and depreciation of capital facilities, should also be considered in an appropriate costing system.

Common service costs should be taken into account in one manner or another in determining program priorities, expansion or reduction of service, or make-or-buy decisions, so that user departments will be conscious of the cost of services now provided free but these should be included only as memorandum entries in departmental budgets.

The question of charging for common services is extremely complex and has not yet been resolved. It is now under study in Treasury Board. Present practices will continue pending the outcome of these studies. However, in order to avoid unnecessary interdepartmental billing, specific proposals for common services should be brought forward, adequately supported by a statement of the purposes and advantages to be derived.

8. Internal accounting control

Internal control includes procedures necessary to ensure accurate and reliable accounting data in accordance with prescribed policies together with devices to safeguard assets.

The system of control should be designed to include the following features.

- (a) The work of one employee should be automatically checked but not duplicated by the work of another.
- (b) No employee should be vested with complete authority over all aspects of a transaction.
- (c) Record-keeping should be separated from custodial or operating functions.

(d) Automatic data-processing should be used wherever it is practical and economical.

Examination of the government's present practices and procedures have shown in many instances that insufficient attention has been given to this phase of accounting. Needless duplication resulting from the general practice of repetitive checking is not only extremely expensive but engenders a false sense of security. Furthermore, staff responsible for initiating expenditures know that their requisitions will be checked by others, not once but several times. In these circumstances, it is possible that their sense of responsibility for the propriety and accuracy of accounts may diminish.

Duplication can however be avoided, and it is apparent that internal controls must be maintained in order to protect the Crown from errors, illegal payments, over-payments or fraudulent transactions. Even with the present duplication, quite extensive in itself, inadequate controls exist in a number of places.

Treasury Board has recently issued a Management Improvement Policy, MI-4-66, on the subject of Revenue and Accounts Receivable Control, included as Appendix No. 2.

Furthermore, accounting control over inventory has been found to be either ineffective or non-existent in many areas. Frequently there is an inappropriate division of duties that permits the record keeping to be performed by the persons responsible for the custodial function, and seldom are stores accounting systems integrated with inventory control systems to provide information on the effectiveness of material management.

Treasury Board policy on these matters may be found in the Management Improvement Circular MI-1-65 entitled "Guide for Material Management in Government".

9. Interpretation

There will continue to be a need for consistency in the interpretation of government statutes, rules and regulations and all doubtful cases should continue to be referred by departments for interpretation and advice to the authorities branch of the Comptroller of the Treasury, regardless of where the accounting work is being performed.

If a department wishes to do something that in the opinion of the authorities branch is contrary to the law or statutes, further reference may be made to the Department of Justice. If this ruling is upheld, then a department may seek assistance from the Department of Justice in proposing amendments to the law or statutes, where such amendment would enable the department to carry out its programs more effectively.

On the other hand, if the interpretation given by the authorities branch relates to Treasury Board rules or regulations, departments may make representations to Treasury Board itself for reconsideration of the rules as they apply to the effective administration of a given program.

10. Mechanization

New systems of financial management will generate a greatly expanded need for more rapid production of information of many kinds. The savings that would result from reductions in the multiple processing of documents and elimination of manually prepared ledgers should substantially affect the costs of implementing modern techniques. Therefore the use of mechanized systems, including automatic and electronic data-processing, should be fully considered in

developing accounting procedures as part of an integrated or total information system. Feasibility studies should be conducted with the advice of departmental management analysis units, the management analysis division of the Civil Service Commission or through recognized Canadian consultants. In the event that the use of electronic computers is recommended, technical advice should be sought from the central data processing service bureau on machine systems and programming, when such advice is not available in the department.

11. Assistance and advice

In the design and development of accounting systems, departments are encouraged to avail themselves of the services of the accounting advisory services branch of the Comptroller of the Treasury and, where necessary, recognized Canadian management consulting firms.

CHAPTER VII

Operational Audit

As the process of decentralizing control to departments proceeds, the need emerges for operational audits specially designed to inform both the department and the executive branch of the government whether the department is using its resources both legally and effectively.

Each deputy head will decide, in consultation with Treasury Board, whether or not he requires such an audit and, if so, to what extent. The possible use of the audit services branch of the Comptroller of the Treasury should be considered. If its services are retained, the same requirements and procedures should be used as for any other auditor. This is the subject of Section I. Section II will deal with audit for the executive.

SECTION I

DEPARTMENTAL AUDIT

1. Scope

The operational audit function has an important place in all departments to review and appraise the soundness, adequacy and application of all accounting, financial, and operating controls. Such an audit therefore is not merely an exercise in accounting, but takes into consideration the use of all departmental resources.

Operational auditing should not be confused with traditional financial auditing by which auditors examine and report on the reliability of balance sheets and operating statements of commercial enterprises. Neither should it be confused with a completely exhaustive investigation of transactions in a particular area to determine the existence of a fraud or the effect of a particular decision. First and foremost, it should be recognized as a service to management by which operations can be improved by action on carefully considered recommendations to management from the auditors.

Many terms have been used through the years that attempt to describe this type of audit such as test audit, general audit, internal audit, functional audit, and management audit. All or any of these names could apply in given circumstances to what is called operational audit, but what this guide stresses is that it is not the name but rather the approach and attitude of the auditor that are important.

The audit of the operations should be sufficiently broad to ensure that proper procedures are being followed and should highlight instances of:

- (a) inadequate security and fraudulent practices;
- (b) unsuitable policies, standards and regulations;
- (c) non-adherence to standing policies, regulations, and procedures;
- (d) deficient work procedures or ineffective use of staff;
- (e) inefficient material management practices;
- (f) unreliable reports and records;
- (g) inefficiency in administrative methods and procedures;
- (h) weaknesses in internal control;
- (i) inappropriate use and development of automation; and
- (j) any other operational practices that require examination.

In addition, the audit staff should be alert for any outstanding innovations that have been developed within a particular area to carry out its functions more effectively, and the auditor in his report should recommend that these innovations and ideas be considered for possible adoption in other similar areas within the department.

2. Methods and procedures

The auditor should approach his task with a professional attitude and in a spirit of helpfulness rather than destructive criticism.

He should win and hold the acceptance of the management team by convincing them that he acts in their interests and has a sympathetic understanding of management problems.

Basic techniques to be developed within an audit staff should include:

- (a) use of instruction manuals to guide the staff in the proper conduct of auditing assignments;
- (b) staff training courses to develop the required skills;
- (c) use of working papers to assist subsequent audits, enable supervisors to assess the quality of the work, and support the conclusions and recommendations of the audit report;
- (d) formal scheduling of the staff's activities on the basis of the time budgets, prepared in advance, to achieve the most effective distribution of time and effort;
- (e) development of methods of detecting areas warranting particular attention, since the relative importance and relative risk help to determine the extent of audit procedures; and
- (f) discussions of audit findings with heads of units being reviewed, before submission of formal reports.

3. Scheduling

The frequency of audit is a matter of judgment. As a general rule, audits are conducted on a continuing or cyclical basis, ensuring that each important segment of an organization is examined

at least once a year, but that less important ones do not escape examination. Areas most susceptible to errors or misappropriation should receive the greatest attention.

Audits may be conducted at the request of management, or as a result of a planned audit schedule prepared by the audit group. This schedule should be worked out with a view to optimizing employment of the audit staff, but should be flexible enough to provide for special studies or unexpected developments that might occur. The following criteria should be considered by the head of the audit group, when planning the schedule.

- (a) A thorough understanding of the objectives of the department or agency should indicate those areas of prime importance that should be subjected to audit.
- (b) A review of the organization chart and various accounting and management reports should suggest many subjects for audit.
- (c) Conditions disclosed by previous audits should determine the appropriate interval before conducting repeat audits.

4. Planning

When the subject matter has been established from the audit schedule, the auditor must familiarize himself with the objectives and organization of the specific area to be audited.

The familiarization process should include, amongst other things, the review of:

- (a) the accounting and management reports produced; and
- (b) the previous audit reports and working papers where appropriate.

Thus armed with some knowledge of the function, the auditor should discuss with the manager the general operation of his area of responsibility. This also provides an excellent opportunity for the auditor to outline his own role and enquire if there are any particular areas the manager wishes to have reviewed in depth.

The auditor should then prepare his audit program to suit the particular characteristics of the subject matter. It should be an orderly plan of work to be carried out, rather than a check list of steps to be taken, and it should be sufficiently flexible to allow for changes as circumstances may require in the course of the audit.

5. Performing

It is not possible, nor is it desirable, to lay down a complete standard audit procedure, but the following rules have universal application and should be followed in the course of the majority of audits.

- (a) Operating procedures should be reviewed by discussion and observation of the work performed by members of the area being audited, to serve as a basis for the evaluation of internal controls.
- (b) The procedures should be tested by the auditor by following through a sample of the work material from source to destination within the audit area. He should use this knowledge to extend his review to areas that might not have been otherwise apparent.
- (c) The auditor should maintain an objective approach during this review and continually ask himself what he would want to know if he were the manager. In this way he should be able to provide a constructive management service, rather than merely checking up on management.

- (d) Where accounting records are predominant in the area under audit, he should analyze the major accounts and test their reliability.
- (e) Throughout this review the auditor should maintain contact with management, observe lines of authority, and verify his information with reliable sources.
- (f) When the procedural review and financial analyses have been completed, the auditor should relate them to the objectives and policies of the department as a whole. He should extend his inquiry into any areas where he considers that he might provide a service to management.
- (g) Audit working papers should be prepared for each phase of the audit and should indicate the nature and extent of the work done together with any conclusions developed.
- (h) A draft report of the audit findings should be prepared by the auditor, discussed with the appropriate managers, and their comments noted in the body of the report.

6. Reviewing and reporting

The auditor should discuss his findings with his superior. This should include a review of the draft report and the supporting working papers. In this way the audit supervisor will be in a position to assess the effectiveness of the audit and to evaluate the performance of his staff.

The following points should be considered by the auditor in preparing his reports.

- (a) It should be addressed to a person specifically designated for that purpose.
- (b) Situations that are handled extremely well should be noted briefly, and if the situation is generally well controlled, or if there are no major findings, these facts may be mentioned in the introduction to the report.
- (c) The scope of the audit should be clearly indicated.
- (d) Audit findings that have not been resolved at a lower level of management and that require action at the highest level, should be presented in a covering letter.
- (e) Only items of significance should be included. Many minor discrepancies may be disclosed and corrected during an audit and need not be reported upon.
- (f) They should be easy to read and properly indexed.
- (g) Each item should indicate the condition observed by the auditor, the weaknesses inherent in the condition, recommendations for remedies, and the benefits to be derived.
- (h) Relevant comments of the manager should be included under each observation to indicate whether or not points that have been raised have been resolved.

7. Organizing

Since auditors do not sit in judgment over the managers whose operations they examine, they must always be conscious of the limits of their own role. Responsibility for taking corrective action on auditors recommendations must always rest with the line manager.

The organizational status of the auditor and the support given him by management will, in a large measure, determine the benefits to be derived from the auditing function.

The size of the audit organization will vary in accordance with programs and activities carried out by a department. Although the audit staff may, if convenient, be divided into teams

that are located in the field as well as at headquarters, it is desirable that the head of the audit groups, report to the highest possible management level: the deputy head of the organization. The head of the audit group must be independent of all regular line accounting functions that he is to audit. Demands on the time of the deputy head may require giving responsibility for this function to some other senior officer in the organization. However, such an assignment should be made with great care and as far as possible should be made so as to preserve the independence of the audit.

The organization within the staff of the audit group will depend upon the requirements of the particular department or agency. It is desirable to have a staff with mixed backgrounds such as:

- (a) college graduates with little or no experience;
- (b) employees with a few years of departmental experience and an aptitude for auditing;
- (c) accountants with many years experience in a department or auditing experience in industry;
- (d) departmental employees with considerable experience who are being given audit work to round out their experience and who are considered potential managers; and
- (e) specialists in such fields as engineering, operations research, scientific research, and data-processing, as may be appropriate in particular circumstances.

Audit personnel should be rotated on recurring audits wherever possible. This not only broadens the experience of the auditors, but also permits a fresh approach to successive audits. This rotational concept may be extended throughout the department as the high turnover of personnel in such audit groups makes available staff suitable to fill managerial positions.

Depending upon the size of the audit group and the nature of the audits undertaken, the staff may work in teams or singly. In either case, there should be team leaders or supervisors for each group to review reports and give general supervision on behalf of the head of the audit group.

Although there should be a continuing training and education program within the audit group, it is generally recognized that doing the work under intelligent and sympathetic supervision is the best training of all.

SECTION II

AUDIT FOR THE EXECUTIVE

Treasury Board and if necessary Cabinet, must be assured, through an audit, that the authority delegated to departments is used as intended. The Glassco Commission supported this view when it stated that the executive should not rely exclusively on the Auditor General to point out inadequate financial control, but should fulfill its own responsibility by ensuring that departmental managers are exercising properly the extensive authority that will be placed on them if the recommendations of its report are adopted.

Although the responsibility for and the exact method of operation for executive audit remains to be decided by the government, it seems highly probable that it will be authorized. Plans for financial management should therefore take these eventualities into account.

The audit's depth and scope will be inversely proportional to the adequacy of the department's operational audit. That is to say, the necessity for an executive audit will be greater in departments that have not instituted a satisfactory system for operational audit.

Introducing Financial Management

The introduction stressed the importance for all departments and agencies to move ahead as rapidly as possible with improving financial management. For those who have already made substantial progress, the message of this guide is to keep up and speed up the good work. Others, however, are still at various stages of planning, or even thinking about planning. To this group the guide should act as an accelerator conveying the sense of urgency Treasury Board attaches to such improvement throughout the public service. Accordingly, this last chapter is addressed particularly to those who ask, "Where do we start and how do we proceed?" There are several points to bear in mind.

1. Appoint the DFMA or select a departmental officer with appropriate professional qualifications, to introduce financial management. In turn, his first task is to expound the key notions of the new system to his colleagues and win their support in principle for it. From this missionary work will emerge recognition of the logical priority to be given to a department-wide review to describe the existing system in sufficient detail to identify specific areas where further studies are needed.
2. Next describe the scope and depth of the review. Since a system of financial management is designed to promote more effective and economical operations by the greater use of financial management techniques throughout the department, it follows that the system ultimately to be adopted should be based on an assessment of the entire management function in the department. This can only be made by means of a review covering the main components of that function: organization and operations, financial management, and personnel administration. Guidelines on the major subjects to be reviewed are given below.

(a) Organization and Operations

- (i) The organizational structure should be examined to decide whether it has to be changed so as to permit the effective application of the concepts of program budgeting and whether the degree of decentralization is appropriate.
- (ii) The duties and responsibilities of all key managerial positions, both line and staff, should be reviewed for precision in the light of the new concepts of departmental management responsibility.
- (iii) The extent of delegation of authority for decision-making and the accountability of managers should be considered.

(b) Financial Management

A complete review in depth of the existing methods of financial management should be undertaken. Criteria for judgment should be taken from this guide.

(c) *Personnel Management*

As the review of organization, operations, and financial management progresses it may be useful to review various elements of personnel management. Suggested guidelines for this review are set out in Appendix 5.

3. Prepare written terms of reference for detailed studies required as a result of the review.

Experience has shown that it is indispensable for the deputy head himself to give the team written and comprehensive terms of reference. This document should proclaim to all concerned that specific operations are to be brought under critical and impartial review, which will require intelligent and willing cooperation at all staff levels.

4. Next decide how, when, and by whom the specific studies are to be made and assemble the team to make them. Since the machinery of government must continue to operate even while its parts are being studied, members of the team should be freed from all operational duties for the duration of their service on it. In fact, it is essential that the team should have sufficient members from the operating staff of the department permanently assigned to it. These members have invaluable contributions to make by giving a full and accurate picture of their own sphere of operations and in addition, by participating on such a team from the outset, they are better able to ensure the continuing effectiveness of the system when it is implemented.

The sources of staff for the study team will include some or all of the following:

- (a) departmental specialists,
- (b) staff from the accounting advisory services branch of the Comptroller of the Treasury,
- (c) staff from the management analysis division of the Civil Service Commission, and
- (d) recognized Canadian management consultants.

Whatever team may be chosen, the DFMA or other appropriate officer should be a member and, in a purely departmental team, the senior member. If outside consultants are used, one of them should be designated project director. Treasury Board is in the process of preparing guidelines designed to help departments select management consultants, to prepare terms of reference for consulting services, and to conduct management studies.

5. The Treasury Board program officer should be consulted at all stages in the development of the specific studies in order to expedite action by Treasury Board or its secretariat.

6. As the various phases of the study are completed, recommendations that form part of the plan for implementation should be brought forward for approval in principle by the board, wherever it is administratively possible to do so. For example, the board and department have to agree as to the description to be used of all programs and their related activities before installing a reporting system.

7. As the studies proceed, another important series of events should be occurring: training staff in their new duties before implementation can be successfully undertaken. Large departments usually have their own training sections. Smaller ones without them should consult the Civil Service Commission, the specialists on the Treasury Board staff, and the program officer for assistance in devising suitable training programs. In any case training as required should begin as soon as the implementation plan for an area or a function has been approved.

8. Although the complete plan should be submitted to the Treasury Board secretariat for review, selected components may require Treasury Board approval. In the unlikely event that no changes are recommended, a report to the board should still be made, giving the results of the review and reasons for maintaining the present system.

POSTSCRIPT TO THE READER

ALPHONSO'S SIGH

History records that Alphonso X of Castile, called the Wise, was not only a man of piety but a great patron of astronomy. When he was initiated into the intricacies of the Ptolemaic system, with its epicycles, excentrics, and deferents, he sighed: "If the Lord Almighty had consulted me before embarking on the Creation, I should have recommended something simpler."

Like Alphonso, the reader, as he made his way through this guide, no doubt sighed for a simpler system of financial management. But the realities of our time and their consequences for government have ruled it out. Advances in science and technology not only continue, but grow at accelerating rates. The public constantly increases its demands on government for more and better services, greater security, and broader social justice. And, in its turn, government has to make greater demands on all the resources, human and material, at its disposal. All these trends challenge government, not only to adapt its existing machinery and methods, but also to find or invent new machinery and new methods. Thus, permanent innovation and adjustment, with increasing sophistication, not a static and sweet simplicity, have become the hallmarks of modern management.

APPENDIX 1

MANAGEMENT IMPROVEMENT POLICY

MI-3-66,

April 28, 1966

T.B. 654.193,

SUBJECT: FINANCIAL MANAGEMENT

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1. Objective

To promote more effective and economical operations by the greater use of financial management techniques.

2. Introduction

Treasury Board, after considering reports by consultants and public service experts on the applicability and value of the recommendations for financial management by the Royal Commission on Government Organization, has directed that this policy statement be distributed to all departments and agencies.

A Treasury Board Guide on Financial Management to be issued shortly will present an elaboration of this policy statement.

3. Organization for Financial Management

Heavier demands will be made on the use of financial management techniques as a result of the greater delegation of authority to department and agency heads and from them to departmental officers. The establishment of an appropriate financial management unit is an essential step towards the introduction of these techniques.

Under each deputy head this unit performs primarily a staff function of service and advice to line management at all levels.

To ensure the consistency and quality of financial service and advice it is essential that these services be integrated at the various levels of management in any one department under the functional direction of a senior officer responsible to the deputy head. After assisting his department to select and put into effect the most suitable financial management systems (See Section 8.), his continuing duties would be to provide service and advice on financial management matters within the department. A suitable title for this position might be Departmental Financial Management Adviser, and other officers with similar functions, depending on their location, Branch Financial Management Advisers, Regional Financial Management Advisers, etc. Alternatively, Departmental Controller might be used as a title more in keeping with industrial usage.

To ensure that sound financial management techniques are promoted and implemented it is essential that financial services staff be well qualified, preferably to professional standards.

The extent and level of staffing for financial services will depend upon the size and complexity of the department or agency concerned. The availability of common accounting and advisory services must also be taken into account.

4. Forecasting and Planning for Financial Management

The forecast of public revenue and expenditure is of vital importance to the economy as a whole, as well as to the effective management of government activities. Departments and agencies, therefore, will be expected to introduce techniques necessary for making realistic and dependable estimates with both short-range and long-range implications. These techniques should take into account not only anticipated revenues and expenditures but also anticipated cash requirements, in such form as may be necessary for the Comptroller of the Treasury to provide meaningful cash forecasts to the Minister of Finance.

Program budgeting will be required to give Parliament, the executive and management a clear insight into the primary purposes of departmental operations so that alternatives may be evaluated and policy decided. A program, defined as a major departmental function designed to achieve specified objectives that have been authorized by Parliament, should be:

- (a) clearly identified with the objectives of appropriate legislation to fully justify its purpose;
- (b) complete in itself and should include only related tasks to simplify, as far as possible, the determination of its total cost; and
- (c) capable of assignment, as far as possible, to an official with authority and responsibility for effective and economic achievement of results.

Each program will be broken down to identify both:

- the activity, indicating the kind of work done (e.g. Health, Education, etc.) and
- the responsibility centre, indicating the organizational location and level of management (e.g. a particular division or unit such as regional and district offices).

This breakdown is designed to:

- (a) assist the planning of work, the selection and application of priorities, and the evaluation of results;
- (b) make possible the maximum delegation of authority and allocation of responsibility compatible with the achievement of effective and economic results; and
- (c) permit the use of advanced techniques of financial management such as budgetary control, cost and responsibility accounting.

5. Budgetary Preparation, Reporting and Control

Financial management systems should be designed to produce relevant, orderly, and above all timely information to be used for forecasting, planning, evaluating, co-ordinating and controlling the various activities concerned.

Budgetary control, within the concept of responsibility accounting which is now being emphasized to stimulate a greater sense of managerial responsibility, begins with the first line of accountable officers who are called upon to forecast in accordance with general plans, their short-range and long-range operational requirements converted into financial terms. These budgets, duly reviewed at higher managerial levels, form the basis of program budgets and estimates submissions.

It follows that the value of the financial management system is largely determined by the following factors:

- (a) the existence of an operational plan, or a set of alternative plans, on which financial forecasts and plans can be based;
- (b) the adequacy of the flow, upwards and downwards in the organization, of information that may affect the scope and nature of work to be done so that budgetary estimates will be dependable, realistic and up to date;

- (c) the accuracy of supporting data, such as manpower and material requirements essential for the work to be done; (This can be assured only through operational planning by line management using planning and control techniques, systems and procedures analysis, and work measurement systems.)
- (d) the appropriateness of budgetary information to meet the needs of management; (In this respect the budget or its parts should be:
 - (i) approved at all appropriate management levels within the department to ensure that the requirements at each level are met;
 - (ii) approved by Treasury Board, through the program officer, to ensure that the requirements for executive and Parliamentary control are met;
 - (iii) approved for any changes by the appropriate level of management in accordance with Treasury Board requirements (See 5(f) (iii) below.); and
 - (iv) consistent in the major features of design and format to facilitate long-range forecasting and comparison from one year to another.)
- (e) its adaptability to provide periodically, automatically, and promptly such reports as are necessary for each management level to control the operations, including the executive and Parliament; (In this connection the feasibility of automatic data-processing should be fully explored.)
- (f) the existence of adequate financial controls, in particular:
 - (i) the clear allocation of funds, appropriated by Parliament, to managers on a budgetary basis;
 - (ii) the granting of appropriate authority for spending these funds;
 - (iii) the obtaining of Treasury Board approval, according to its requirements, for transfer of funds between either major activities or responsibility centres; and
 - (iv) optimization of non-tax revenues (See Management Improvement Policy No. MI-4-66.).

In the development of program and activity budgeting, departments should provide for the classification of all proposed expenditures under the three broad divisions of vote structure:

- (i) Operation and Maintenance,
- (ii) Capital, and
- (iii) Grants, Subsidies, and Other.

Where operations are such that continuity of financing would be a distinct advantage over the general system of annual appropriations, such as production of motion pictures and printing government publications, departments and agencies should investigate the advantages of using working capital advances, previously called Revolving Funds (See Management Improvement Policy No. MI-5-66.)

6. Accounting Systems and Operations

Departments are responsible for determining their own accounting needs and ensuring that their accounting systems are designed adequately to meet those needs.

Normally the services of the Comptroller of the Treasury will be enlisted to perform accounting services for departments. On the other hand, a department and Treasury Board may agree that the department should perform its own accounting operations; under those conditions the department must take into account the responsibilities of the Comptroller of the Treasury for:

- (i) cheque issue,
- (ii) preparation of Public Accounts,
- (iii) fiscal accounting for the Government of Canada,
- (iv) commitment control,
- (v) pre-audit of expenditures, and
- (vi) cash management.

Moreover, departmental systems must contain adequate controls to safeguard the Crown from illegal or improper payment action and be effective and economical in their operation.

In the design of accounting systems, the following further points should be noted.

(a) Classification and coding of accounts should be done to meet the needs of:

- (i) management in the department,
- (ii) Comptroller of the Treasury for Public Accounts, and
- (iii) Treasury Board for executive control.

A study is in progress for the purpose of introducing a common classification and coding system that will meet the above needs and will facilitate the use of accounting information in economic analysis and in drawing up the national accounts.

(b) Commitment accounting and control may in future be modified but in the meantime departments should, in co-operation with the Comptroller of the Treasury, extend the use of "blanket" commitments as part of the system of budgetary control on a responsibility basis.

Commitment control for capital votes will be on a multi-year basis to show the true amount of commitment that must be honoured in any one and in all years.

(c) Accrual accounting, advocated by the Glassco Commission for extensive use, has been found in subsequent detailed studies to have many advantages; however, it should not be introduced where cash accounting is adequate for management purposes.

(d) Cost accounting techniques will be required as part of the system of program budgeting to evaluate the units of work or service produced in different circumstances and places.

- (e) The charging of common services is now under study and appropriate policy will be formulated in the near future.
- (f) Internal control devices should be built into accounting systems particularly those for the control of expenditures, cash receipts, inventory, payroll and the safeguarding and disposal of assets.
- (g) The interpretation of government statutes, rules and regulations should be consistent, and doubtful cases should be referred to the Authorities Branch of the Comptroller of the Treasury.
- (h) The use of mechanized systems, including automatic and electronic data-processing, should be fully considered in developing accounting procedures as part of an integrated or total information system. Feasibility studies should be conducted with the advice of departmental management analysis units, the Management Analysis Division of the Civil Service Commission or through recognized Canadian consultants. In the event that the use of electronic computers is recommended, technical advice should be sought from the Central Data Processing Service Bureau on machine systems and programming when it is not available in the department.
- (i) Advisory services and assistance in developing accounting systems are available from the Accounting Advisory Services Branch of the Comptroller of the Treasury and recognized Canadian consulting firms.

7. Operational Audit

Each deputy head in consultation with Treasury Board will decide whether or not he requires an operational audit and to what extent, bearing in mind the services available from the Audit Services Branch of the Comptroller of the Treasury. The greater delegation and decentralization of authority will require an increased emphasis on the role of operational audit.

In setting up an operational audit the following points should be kept in mind.

- (a) Operational auditing is an independent appraisal activity within an organization for the review of accounting, financial and other operations, as part of management's control system.
- (b) The head of the operational audit group should be responsible to an officer of sufficient rank in the organization to ensure adequate consideration of and effective action on the audit findings or recommendations.
- (c) It is a staff function and, therefore, the auditor does not exercise direct authority over persons in the organization whose work he reviews.
- (d) As complete objectivity is essential to the audit function, the auditor should not develop and install procedures, prepare records, or engage in any other activity that he normally would be expected to review and appraise.
- (e) The auditor should be free to review and appraise policies, plans, procedures and records, but this does not in any way relieve other persons in the organization of their responsibilities.

- (f) Although the scope of the internal audit operations will be determined by the deputy head according to circumstances, the auditing function should be planned so as ultimately to include:
- (i) the review and appraisal of the soundness, adequacy and application of existing management controls and reports;
 - (ii) ascertaining the extent of compliance with established policies, plans and procedures;
 - (iii) ascertaining the extent to which assets are accounted for and safeguarded from losses of all kinds; and
 - (iv) ascertaining the reliability of accounting and related data developed within the organization.

8. Introducing Financial Management

In introducing improved financial management the following points should be observed.

- (a) The Treasury Board program officer should be consulted at all stages of development to expedite the eventual review by Treasury Board.
- (b) As a first step, authority and responsibility for the development of financial management should be given to a departmental officer with appropriate professional qualifications.
- (c) This officer should:
 - (i) determine the departmental requirements and formulate a preliminary plan for action;
 - (ii) identify and specify areas requiring further detailed studies;
 - (iii) prepare terms of reference for these studies; and
 - (iv) determine how and when these studies will be done, using departmental personnel, Central Advisory Services, and Canadian management consultants, as may be necessary.
- (d) While the complete plan should be submitted to the Treasury Board secretariat for review, selected components may require Treasury Board approval.

D.R. Yeomans,

Assistant Secretary.

APPENDIX 2

MANAGEMENT IMPROVEMENT POLICY

MI-4-66

April 28, 1966

T.B. 654.194

SUBJECT: REVENUE AND ACCOUNTS RECEIVABLE CONTROL

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1. Objectives

To promote the earning of non-tax revenue and to improve controls over revenue and accounts receivable in general.

2. Background

The Standing Committee on Public Accounts, in its sixth Report 1964, after considering reports of the Auditor General, stated:

The Committee is concerned that weaknesses exist in the internal control with respect to accounts receivable and suggests that Treasury Board have the matter studied with a view to establishing procedures designed to ensure that amounts due to the Crown are adequately recorded and that an accounts receivable control system be instituted. Collection procedures must be tightened up and firmly enforced.

The Glassco Commission Report also made similar references to deficiencies in revenue control. Furthermore it criticized some failures to earn optimum non-tax revenue.

3. Responsibility for Non-Tax Revenue

Non-tax revenue is an important element of management's financial responsibility and should be given particular attention. It should be departmental policy wherever economically and administratively feasible to charge for all goods supplied or services rendered to the public, including those now supplied free, unless there are provisions for specific exemption. The charging for common services is under study for policy guidance at a later date. In the meantime, arrangements made to cover specific instances will continue.

The following criteria should apply.

- (a) Charges should at least cover all direct and indirect costs of providing the service.
- (b) Cost systems should be introduced where appropriate to furnish accurate costs of rendering services.
- (c) The comparison of these costs with revenue derived from the services can thus be brought to the attention of management through a reporting system, and the executive and Parliament through the estimates.
- (d) Numerically controlled invoices should be used wherever goods are supplied or services rendered or where a claim against a debtor arises. Cash transactions do not necessarily require an invoice but must be properly recorded and adequately controlled. (See 4(c) (i) below.)

4. Accounts Receivable

(a) General

An account receivable is an amount claimed against a debtor. In government accounting there are several ways in which accounts receivable may arise, such as:

- (i) tax revenues resulting from the application of various acts of Parliament,

- (ii) returns on investments,
- (iii) issue of licenses and permits,
- (iv) proceeds from sales, services and service fees, and
- (v) refunds of expenditures.

(b) Records

(i) Control Account

The books of account must contain a control account to which is charged the total of amounts set up as accounts receivable and to which is credited the total of all amounts credited to individual accounts receivable,

(ii) Subsidiary Records

In support of this control account subsidiary records must be maintained showing the total amount outstanding for each debtor at any time. Each debtor's record must be charged regularly with invoices, and credited promptly with payments. Where there are numerous types of revenue or a large number of debtors, it may be expedient to break down the subsidiary records into smaller control units by classification of revenue or section of the alphabet. Each system should be designed to suit the requirements of particular departments.

(c) Control

(i) Control of Cash

As cash is more susceptible to improper use than other assets, it must be more carefully controlled. Steps must be taken to:

- ensure the safeguarding of receipts by the application of appropriate mail handling procedures, “cash blotter” systems, and controlling devices such as cash registers and serially pre-numbered receipts;
- provide adequate security over receipts by the use of appropriate safekeeping facilities; and
- deposit receipts promptly and have bank reconciliations performed by persons other than those handling cash (See also T.B. 589817, December 14, 1961)

(ii) Separation of Duties

Cash handling duties should be performed by persons other than those responsible for keeping accounts receivable records where practicable.

(iii) Reconciliation

An aged trial balance of individual accounts or records should be prepared, reconciled with the control account and reviewed by a senior official. This should be done monthly where practicable.

(iv) Auditing

Operational audit is an important element of control over accounts receivable. It must include such procedures as reporting upon the effectiveness of the prescribed accounting procedures, security practices, methods and routines, and where necessary confirming the accounts in whole or in part by direct written communication with the debtor.

(d) Collection Procedures and Write-Off

General guidelines covering, among other things, the review, collection and write-off of accounts receivable were set out in Treasury Board circular letter, 1963-66, (T.B. 613509). These guidelines must be supplemented by formal departmental instructions detailing areas of particular concern in each department or agency and emphasizing prompt and effective action.

(e) Reporting for Public Accounts of Canada

At the close of each fiscal year, departments are required to forward to the Comptroller of the Treasury a statement of accounts receivable, in such form as the comptroller may designate.

(f) Payment for Services rendered by other Departments or Agencies

Departments and agencies must make prompt payment for services charged to them. Such action will reduce repetitive billing, correspondence, and other costly collection procedures.

5. Accounting

Assistance and advice on accounting procedures and practices are available on request from the accounting advisory services of the Comptroller of the Treasury. Departments should take advantage of this service in the review or revision of their systems of revenue control.

D.R. Yeomans,

Assistant Secretary.

MANAGEMENT IMPROVEMENT POLICY

MI-5-66

April 28, 1966

T.B. 654.195

SUBJECT: WORKING CAPITAL ADVANCES (formerly Revolving Funds)

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1. Objective

To regulate the establishment and operation of working capital advances, subject to any act of Parliament.

2. Background

The Royal Commission on Government Organization recommended an increased use of revolving funds to encourage business-type budgeting and reporting, improve accounting for inventories, and to simplify certain problems created by annual appropriations. A study of the use of revolving funds in government service was undertaken by the Accounting Advisory Services of the Comptroller of the Treasury, in co-operation with the Inter-departmental Committee on Revolving Funds and members of the Treasury Board staff. This circular incorporates the substance of the recommendations that were made to apply improved management techniques within the framework of government organization.

3. Definition

A "working capital advance" means a revolving fund and is an authorization by Parliament to draw from the Consolidated Revenue Fund monies not to exceed a given maximum at any one time sufficient to finance the operation of a program, activity or subdivision thereof on a continuing basis, with receipts in respect to the operation of such program, activity or subdivision thereof credited to that advance so that they will again become available for use.

4. Classification

Working capital advances are to be classified as follows:

(a) Departmental Loans and Advances

- (i) loans to employees of government departments for the purpose of financing the purchase of personal items where the nature of their duties require the employees to have such items; and
- (ii) advances to finance the operations of a segment of a department in a foreign country or in a locality not readily serviced through the regular financial channels of the government;

(b) Stores

purchase and storage of materials and supplies normally for operational use within a department;

(c) Program or Activity

carrying out a definite activity or operation, e.g. production of motion pictures, printing government publications, promoting mobility of labour; and

(d) Miscellaneous

advances for purposes not covered above.

5. Financing

A working capital advance must be properly classified and will be financed by funds drawn from the Consolidated Revenue Fund from time to time as required. The authorized maximum will depend upon operational requirements and must at least be adequate to finance the direct expenditures from the advance account on a continuing basis. All costs of program or activity operations suitable for financing by working capital advances should be included. However, common service costs, provided free by other departments or agencies, must only be treated as memo costs, pending, the outcome of a study now being undertaken by Treasury Board.

6. Surplus and Deficit

Unless Parliament has provided otherwise with respect to a particular advance, annual surpluses must be transferred to the Consolidated Revenue Fund. Annual deficits may be reimbursed from a departmental appropriation or an allotment provided for that purpose.

7. Initiation and Authorization

When departmental management is of the opinion that financing by a working capital advance would be advantageous, a submission should be made to Treasury Board, outlining in general:

- (a) the specific purpose of the advance,
- (b) the advantages of using a working capital advance in the particular circumstances,
- (c) the elements of cost to be charged and revenue to be credited to the advance,
- (d) the amount required to achieve the purpose, supported by relevant data, such as:
 - (i) revenue and operating budget,
 - (ii) cash-flow statement,
 - (iii) inventory turnover rate, and
 - (iv) production schedules,
- (e) any considerations listed in Section 11.

8. Accounting

The accounting system depends upon the requirements of each advance, but must be designed to facilitate effective administration and control. Precise rules and regulations governing the type of accounting systems to be adopted will depend upon the nature and purpose of the operation and the following criteria should be considered.

(a) Departmental Loans and Advances

- (i) Loans – A simple accounting and internal control system involving only the recording and collection of the loan, with interest where applicable.
- (ii) Advances – A “letter of credit” system may be used where appropriate.

(b) Stores

Recognized inventory management and control practices (See also MI-1-65, January 21, 1965). should be incorporated in the accounting system. These practices generally should meet the following requirements.

- (i) Charges directly related to stores operations are included.
- (ii) Formal stock records are maintained and reviewed, and regular stocktaking procedures followed.
- (iii) The recording of costs and prices are based on an appropriate system. Standard pricing is advocated where appropriate.
- (iv) An efficient requisitioning system is to be used.
- (v) An appropriate system of authorities is to be incorporated.

(c) Program or Activity

The accounting system for a program or activity financed by a working capital advance should:

- (i) incorporate all costs directly associated with the program or activity including common service costs; (Where no charge is made for common services they should be included as memo items.)
- (ii) provide comparison of actual results with the approved budget;
- (iii) facilitate sales and expenses analysis; and
- (iv) use a cost accounting system where applicable.

(d) Miscellaneous

The accounting systems in this classification may be of a wide variety and the general criteria are that they should be adequate to:

- (i) control the activities within the advance; and
- (ii) disclose the condition of the advance as required.

9. Budgeting

An annual budget for each operation financed by a working capital advance must be submitted to Treasury Board with formal departmental estimates unless specifically exempted. This submission should state:

- (a) expected revenue from all sources,
- (b) expenses necessary to generate this revenue,
- (c) anticipated capital expenditures to be financed from the advance, and
- (d) estimated surplus or deficit for the year.

The submission should show comparisons with the previous year and the expected actual results for the current year, and should be accompanied by other factual information where applicable such as:

- (i) estimated cash receipts and disbursements,
- (ii) comparative industrial price lists, and
- (iii) production yields.

10. Reporting

Interim reports may be required by Treasury Board and an annual report is required at the close of each fiscal year including, where appropriate:

- (a) a balance sheet,
- (b) a statement of operations, compared with their budget, and
- (c) a statement of the disposition of the surplus or deficit.

11. Other Considerations

When requesting the establishment of, or an amendment to, a working capital advance, it may be desirable, considering the nature of the advance and in the interests of flexibility of operations, for departments to request authorization in respect to that advance, that:

- (a) surpluses or portions thereof, be carried over to subsequent years;
- (b) in determining the net amount of the advance outstanding at any one time, accounts receivable from other departments and agencies be permitted as a deduction;
- (c) the advance be reimbursed for the cost of any material lost, destroyed, surplus, obsolete or unserviceable where such reimbursement is provided for in the departmental estimates; and
- (d) capital equipment, used in an operation controlled by an advance, be financed from the resources of the advance so that the cost of the equipment is recovered over its useful life through charges made for services rendered or goods supplied.

D.R. Yeomans,

Assistant Secretary.

CONTENTS OF FISCAL ACCOUNTS

The fiscal accounts are governed by Part VI, section 63, of the Financial Administration Act, as follows:

- “1. The Minister shall cause accounts to be kept in such a manner as to show,
 - (a) the expenditures made under and commitments chargeable against each appropriation,
 - (b) the revenues of Canada, and
 - (c) the other payments into and out of the Consolidated Revenue Fund.
2. Subject to regulations of the Treasury Board, the Minister
 - (a) shall cause accounts to be kept to show such of the assets and direct and contingent liabilities of Canada, and
 - (b) may establish such reserves with respect to the assets and liabilities, as in his opinion are required to give a true and fair view of the financial position of Canada.
3. The accounts of Canada shall be kept in the currency of Canada. 1951 (2nd Sess.), c. 12, s. 63.”

The principal classes of assets are:

1. Current assets, including cash, securities held for the securities investment account, and departmental working capital funds.
2. Advances to the exchange fund account for the acquisition of gold and foreign exchange.
3. Sinking fund and other investments held for retirement of unmatured debt.
4. Loans to, and investments in, Crown corporations.
5. Loans to national governments.
6. Other loans and investments, including loans to provincial and municipal governments, subscriptions to international organizations and a number of miscellaneous advances to veterans and others.
7. Securities held in trust for various deposit and trust and annuity, insurance and pension accounts and bonds and certified cheques held in connection with contractors' security deposits.
8. Deferred charges which consist of the unamortized portions of the actuarial deficiencies in the superannuation accounts, representing that portion of the government's liability in respect of these accounts that have not been charged to budgetary expenditure and dis-counts, commissions, redemption bonuses and conversion premiums on loan flotations, remaining to be charged to expenditure.
9. Capital assets, a category set up to cover capital assets that are charged to budgetary expenditure at the time of acquisition or construction and which are shown on the statement of assets and liabilities at a nominal value of \$1.
10. Inactive loans and investments which are not currently yielding interest, profits or dividends.

A reserve for losses on the realization of assets is now shown as a liability but is deducted from the total of the assets.

The main categories of liabilities include:

1. Unmatured debt, consisting of bonds and Treasury bills.
2. Current and demand liabilities, including matured debt outstanding, outstanding treasury cheques, interest due and outstanding, interest accrued, accounts payable, non-interest-bearing notes payable to international organizations and other obligations payable on demand.
3. Sundry funds deposited with the Receiver General of Canada or held in trust for various purposes.
4. Amounts to the credit of various annuity, insurance and pension accounts.
5. Undisbursed balances of appropriations to special accounts, which, in accordance with the legislation under which they are authorized, are available for expenditure in periods subsequent to the fiscal year in which they are granted.
6. Amounts due to the government but in respect of which payment has been deferred; these are contra accounts to corresponding items under "Loans to, and investments in, Crown Corporations", "Loans to national governments", and "Other loans and investments".
7. Suspense accounts, consisting of balances where some uncertainty as to disposition exists.

GUIDELINES FOR REVIEW OF PERSONNEL MANAGEMENT

1. Personnel Management Program

- (a) To review personnel management as an integral part of the total management function to ensure that the departmental personnel program is consistent with policies approved for the public service.
- (b) To review the specialist advice, service and information provided to management by the personnel administration branch, and to recommend improvements.
- (c) To review the personnel records maintained; to assess these records and make recommendations designed to improve their usefulness to management.

2. Staff Relations

To review and assess the adequacy of existing relations between departmental management and organized groups of employees; to review the system for processing grievances; to recommend improvements and to ensure staff relations are being conducted in a manner consistent with approved policies for staff relations in the public service.

3. Manpower Utilization

(a) Manpower Planning

To review the existing plans and procedures for determining long-range staff requirements; to ensure that these plans and procedures are integrated with all other departmental plans and procedures including those required for program budgeting; to assess the adequacy of these procedures and recommend improvements.

(b) Employee Appraisal

- (i) To review the existing methods for evaluating staff performance and to recommend improvements; to reveal the need for training and/or recruitment in order to provide the personnel resources and skills required in the department.
- (ii) To review the existing methods for counselling staff and to recommend improvements.

(c) Recruitment

To study existing procedures, including those involving co-operation and co-ordination with central agencies, for recruitment, selection, employment, induction and promotion of staff, including classified, prevailing rate, contract and other kinds of employees; to assess the effectiveness of these procedures and to recommend improvements.

(d) Staff Training and Development

To examine existing methods of training and developing staff; to suggest criteria and principles to be applied in determining staff training needs; to assess the adequacy of the existing training programs and to recommend improvements consistent with policies approved for the public service.

4. Classification and Pay Administration Procedures

To review existing methods and procedures of classifying positions and personnel and for administering pay plans; to assess the adequacy of these procedures; to insure that they are consistent with policies and standards approved for the public service; and to recommend improvements.

5. Employee Benefits Administration

To review the procedures for administering employee benefits; to assess the adequacy of these procedures and recommend improvements.

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